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ABSTRACT

This booklet on managing credit, 1 in a series of 12, covers all the basic aspects of personal- and family-money management. Suitable for use by high school and college students as well as adults, this handbook tells how to establish credit, determine credit limits, and maintain a favorable credit history. Section 1 on understanding consumer credit presents basic information, including what consumer credit is, pros and cons of credit, the cost of credit, credit worthiness, comparing credit charges, types of consumer credit, sources of cash credit, and consumer credit agreements. Section 2 on managing credit dollars discusses uses of credit, including shopping for credit, handling financial difficulties, and managing credit in the future. Following a list of suggested resources (organizations, books, and pamphlets) are these appendixes: United States credit legislation in brief (act, major provisions, page/reference, penalties for noncompliance, governing agencies), a glossary, and methods for computing credit charges. (YLB)

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money management

Managing Your Credit

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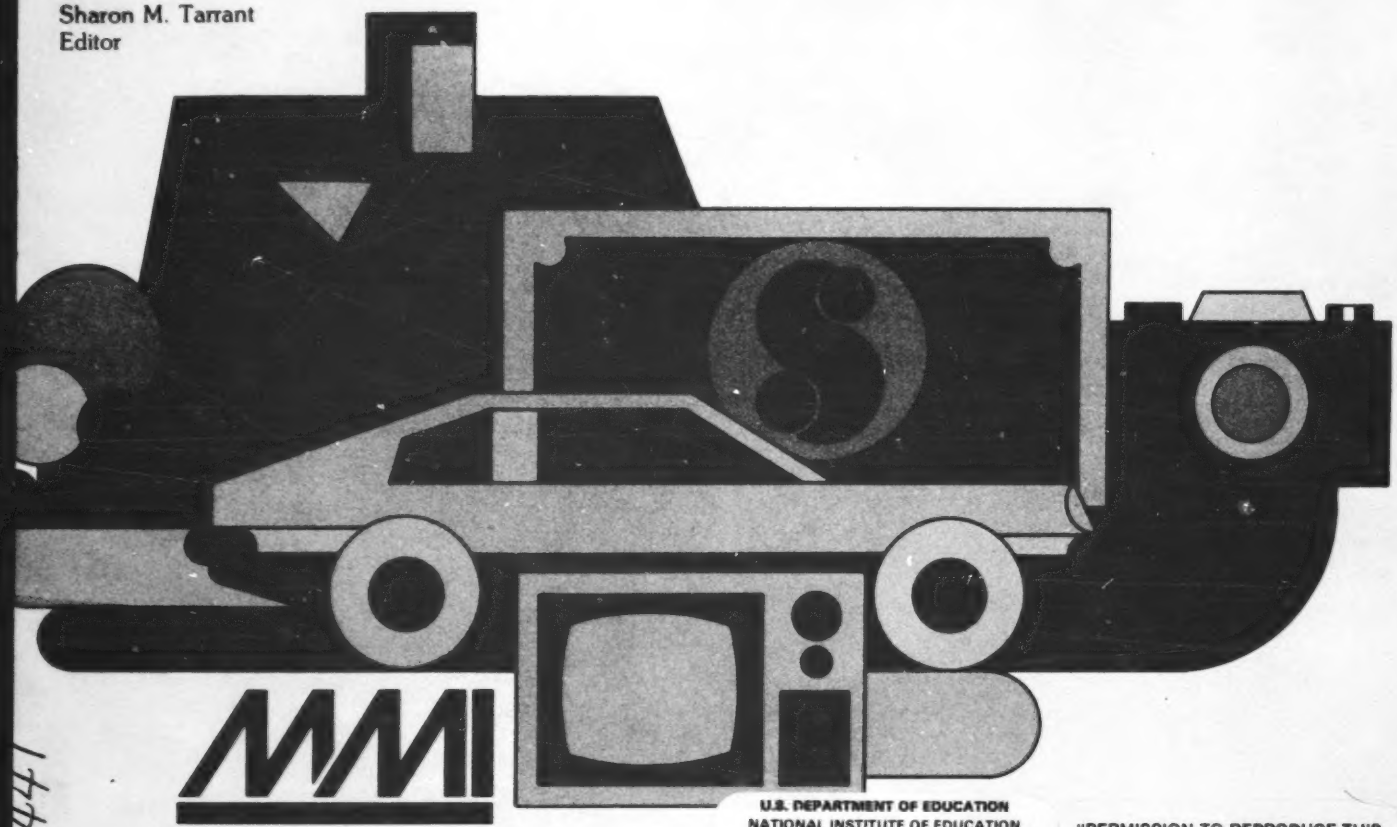

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Introduction

Buying on credit is so popular in today's society that many of us cannot imagine a world without credit—any more than we can imagine a world without automobiles, television sets, automatic appliances, vacations or all the other things credit helps us buy.

But because we have grown up with credit does not mean that we know how to use it wisely—any more than we know how to drive an automobile safely just because we have ridden in cars all of our lives.

Consumer credit is an important financial tool in personal and family money management. Effectively used, consumer credit can help us achieve some of our most important goals in life. Misused, it can create problems and lead to serious financial difficulties.

Every year families and individuals arrange to use billions of dollars' worth of consumer credit. The amount is increasing rapidly as inflation puts an additional "tax" on the items we purchase. In such a climate, the wise use of credit is of utmost importance. This booklet is a guide to understanding consumer credit and managing it wisely.

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Understanding Consumer Credit

Your consumer decisions—to buy or not to buy. . . what to pay—depend on your needs, your values and goals, your income and the goods and services you are considering for purchase. When you buy a suit, you think about the price, style, color, fit, workmanship, fabric and the reliability of the retailer and the manufacturer. When you purchase an automobile, you consider cost, make, style, color, size, construction, special features, warranties and the reliability of the dealer and the manufacturer. When you choose a personal physician, you evaluate his qualifications, his office facilities, his availability, his manner of handling your problem and the cost of his services. When you consider consumer credit, you also should think about all the factors that apply to your situation. This involves understanding:

- **basic consumer credit facts**—what is credit. . . its role in the economy. . . who uses it. . . how is it obtained?
- **the pros and cons of using consumer credit**—what are its advantages. . . disadvantages?
- **the cost of consumer credit**—what determines cost. . . why do charges vary. . . how can they be compared?
- **the types of consumer credit**—retail credit. . . cash loans. . . how do they differ?
- **the sources of consumer credit**—what are they. . . how do they differ. . . what are the advantages and disadvantages of each?
- **the forms of consumer credit agreements**—what is included in credit agreements. . . what responsibilities are involved?

When you understand consumer credit, then you are in a position to more effectively manage your credit dollars.

Consumer Credit—What Is It?

Do you realize that every time you flick on a light switch, take a drink of water or telephone a friend, you are probably using credit? This is called *service credit*. Millions of people use it every day but simply take it for granted. Some may not even be aware they are using credit when they pay for the newspaper, telephone, electricity, water, gas, doctor or dentist *after* services are received.

But there are other forms of credit that are readily recognized. These include *installment loans*, which may be obtained from a variety of financial institutions that lend money, and *sales credit*, which is generally available from stores and merchants who sell goods and services on credit. In fact, credit is so widely used today that we may take it—and what it means—for granted. Just what is consumer credit?

Credit is a way for you to use another person's—or an institution's—money for a predetermined charge. It lets you obtain goods, services or money now in exchange for the promise to pay in the future. Credit involves the present use of future income.

The term *consumer credit* refers to the use of credit by individuals and families for personal needs as contrasted to credit used for business or agricultural purposes.* Consumer credit is based on *trust* in the customer's ability and willingness to pay his bills when due. It works because people, by and large, are honest and responsible.

*__Mortgage credit__—a form of consumer credit—is beyond the scope of this booklet. For a complete discussion of mortgage credit, refer to the Money Management Institute publication YOUR HOUSING DOLLAR, listed on the inside back cover.

The Role of Consumer Credit in the Economy

While headlines lamenting the state of the economy grab our attention, North Americans still enjoy a high standard of living, comparatively speaking. Nearly two of every three American families own their own homes and at least one family car is the rule rather than the exception. Over the last century, industry, skill, knowledge, more efficient machinery and processes, better working procedures and a highly organized financial system have moved us from an agricultural economy to a technological one.

Consumer credit has played and will continue to play an important part in the development of our highly productive economy. Our system of mass production and mass distribution is based on a sound credit system. In order to bring about large-scale production, investors and creditors are necessary to supply the large volume of money needed for business enterprises. In turn, mass production makes it possible for our factories to turn out vast quantities of expensive items such as automobiles, furniture and appliances. But mass production is neither possible nor profitable without mass consumption.

Consumer credit is the vital link between the two. We can recognize easily that a requirement of cash in full limits the demand for major durable goods. Consumer credit makes it possible for families and individuals to pay over a period of time for items that require a major cash outlay.

For example, what would happen if the next time you needed a new car you had to pay "cash on the barrelhead?" Could you save the thousands of dollars a new car costs today? By the time you saved the estimated amount, how much more would one cost? If cash were required, it is safe to

assume few new cars would be purchased. What would happen to the auto industry? With no buyers, production would have to be cut back—the repercussions of which would be felt throughout the entire economy. This in fact has been happening because of the current drop in auto sales. It is not hard to see how, in creating new markets and in maintaining a mass demand to absorb the output of consumer durables, consumer credit helps to create the necessary balance between the supply of and the demand for goods and services.

Our use of credit is increasing significantly each year. As of June 1981, the total consumer installment credit outstanding in Canada was $46.8 billion, according to the *Bank of Canada Review*. In the U.S. as of January 1982, this figure reached $330.1 billion, according to the Federal Reserve Board. Of this amount, approximately 38% could be attributed to automobile loans, 19% to revolving credit (bank cards and check credit), 5% to mobile homes and 38% to all other installment credit, including personal loans and household goods.

Why is consumer credit increasing? A primary reason is inflation. Until the 1970s, the economy had seen steady, strong growth since World War II. Ours had been an affluent society which encouraged the purchase of labor-saving devices and other goods and services, more education, better housing. Generally, these things were affordable for the majority of Americans. Today, paychecks may be larger or an extra income may be added to the family coffers, but it doesn't stretch as far. Inflation has also put a lid on rising expectations. We have having to rethink our definitions of *needs* and *wants*, and adjust our standards of living to deal with a changing economy.

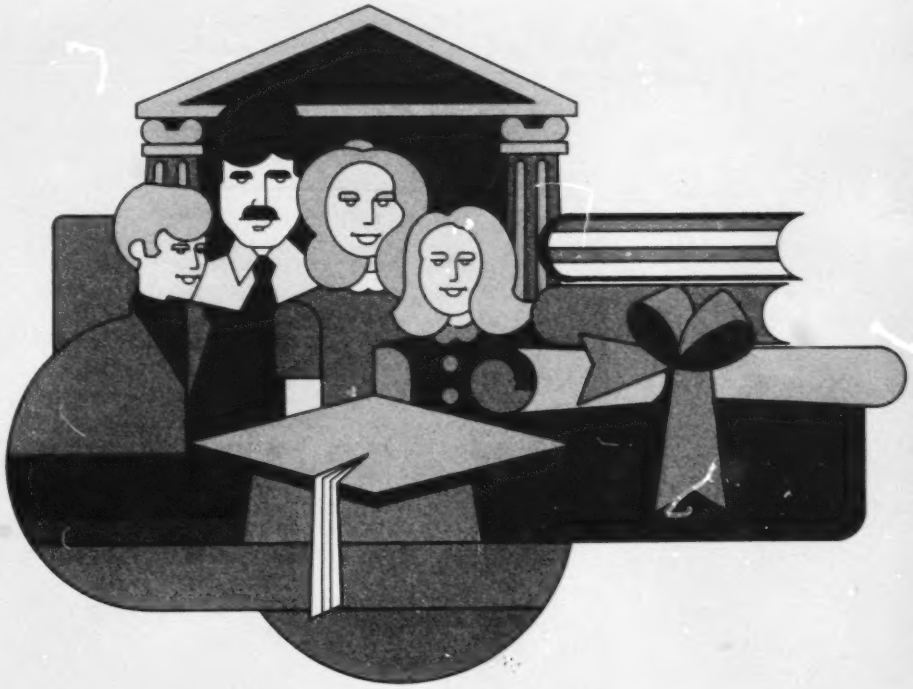
During this transition period, many people have turned to credit, or increased their use of it. This is not necessarily a recommended plan of action! Credit is not an extension of income; purchases bought on credit must be paid for out of future earnings. Using credit to obtain a wanted item that cannot be fitted into a spending plan is a misuse of credit.

The important question to be examined before judging the use of credit is whether the purchase is a sound one in relation to your level of living, expected price trends, present and future income, your management of that income, and personal values and goals.

Who Uses Consumer Credit?

Consumers in all age groups, income levels and occupations find consumer credit helpful in managing their financial affairs. While families have been the major credit users in the past, single consumers are catching up fast. Later marriages, increasing divorce rates and higher incomes are contributing to this trend.

- **Teenagers** may use credit to purchase clothing, gifts, automobiles, etc., to finance an education or place of their own. Those of school age may use their parents' charge cards if the store is given authorization. Teens are legally able to open accounts and take out loans at age 18 in most states and provinces. Credit grantors will probably require a cosigner for these first-time borrowers, however.
- **Single adults** have many of the same expenses as those recently married—home furnishings, small appliances, automobiles, continuing education, travel. If children are involved, credit usage will most likely increase and parallel the spending by families with both parents present.
- **Newly married couples** may use consumer credit to acquire furnishings, household equipment, automobiles and a host of other goods and services necessary to begin family living. More often than not, both spouses will be working, contributing to family income. A word of caution: Family-planning decisions make a big difference in planning the use of credit. If children are planned, will one spouse drop out of the labor force, decreasing income at the same time expenses are increasing? Will both continue to work, adding the cost of child care to other financial obligations? By making these decisions beforehand, couples can adjust spending and credit use to the income available after a child arrives and avoid the credit crunch if one income ceases.



- **Beginning families and families with young children** frequently use consumer credit to handle large expenditures, as this is the stage in life in which many families either buy a home or move to acquire additional living space. Expenses may also include medical attention, insurance premiums, and clothing, equipment and furnishings for the children.
- **Families with adolescent and college-age children** may use credit to meet educational expenses or replace old furnishings. At this stage, earning power is usually at its peak, particularly if both spouses are in the labor force. At the same time, children may be assuming some financial responsibilities with part-time jobs.
- **Families with adult children** usually find that disposable income is greater during this period. With the children grown, they may use consumer credit to remodel and modernize the home, to purchase other durable consumer goods or services which require a major cash outlay, or for travel.
- **Retired persons** may use credit to meet medical needs, to replace old furnishings and equipment and to handle financial emergencies. While income decreases upon retirement, many expenses have done likewise—particularly if the home mortgage is paid in full.

Credit—Pros and Cons

Consumer credit is recognized as a powerful economic tool, but like any other tool, its effectiveness depends on the skill of the user. Wisely used, consumer credit enriches life. Using too much credit or using it carelessly can cause serious financial problems, however. Before using consumer credit, it is important to understand its advantages and disadvantages and to evaluate them in terms of your financial situation. The planned use of consumer credit offers these advantages:

- **The use of goods and services while paying for them.** Consumer credit makes it possible to acquire goods and services as they are needed and to pay for them out of future income. But in doing so, the use of credit should be a part of a long-range spending and saving plan in which payments are worked into the plan over a period of time.
- **An opportunity to raise one's level of living.** Most consumers can do one of two things—wait until they can save enough to pay cash or use credit. Saving for costly purchases, such as an automobile, home improvement or a college education, may mean waiting a long time. Many people prefer to use credit. In some cases, using credit is the only way families can pay for goods and services which require a major cash outlay.
- **A way to handle financial emergencies.** Consumer credit offers at least a *temporary* solution to unexpected financial difficulties which may arise because income is interrupted or decreased due to unemployment, sickness, an accident or death; or when for other reasons bills become too great to be paid out of current income. Families with little or no reserves find they must use credit to meet these emergencies. Others use credit because it offers economic independence in handling financial difficulties. It spares one the alternatives of borrowing from friends and relatives or depleting savings.
- **Greater convenience in purchasing goods and services.** Almost everyone uses consumer credit as a convenient way to pay for utilities and professional services. Charge accounts and credit cards allow shopping and traveling without carrying large amounts of money, the convenience of paying for a number of purchases at once, and receiving records of expenses. Often credit customers enjoy additional advantages such as advance notice of sales, buying on approval, ordering by telephone and greater ease in making returns.

When considering the use of credit also remember these disadvantages:

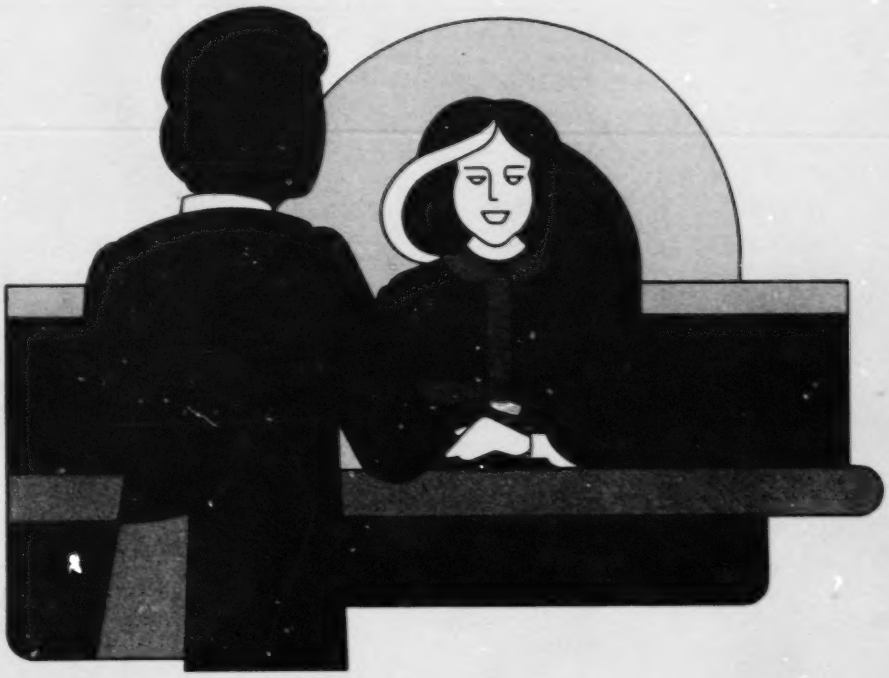
- **It ties up future income.** Credit transactions must be paid for out of future income; therefore, the use of future income becomes less flexible since some of it already is obligated to meet credit payments. Inflation also erodes future income by increasing the prices you must pay for everyday living expenses. If income does not increase to cover rising costs, this may affect your ability to repay credit commitments. Before making a credit purchase, it is important to consider whether the goods and services will have lasting value, will increase personal satisfaction during present and future income periods, and whether current income will continue and/or increase.
- **It may tempt overspending.** Sometimes it seems so easy to buy today and pay tomorrow. Credit makes it easy for consumers to buy on impulse, frequently choosing items which meet neither their needs nor wants. Consequently, they may overcommit income and cause serious financial problems. While credit offers a more convenient way of timing purchases, there is one basic fact to remember: Credit is only a temporary substitute for cash—it must be paid back! Therefore, it is essential to be able to judge how much credit can be used without putting a strain on present and future income.
- **Credit costs money.** It is a service for which one pays. Usually, purchases paid for over a period of time are more costly than paying cash. Therefore, one must decide if making a credit purchase or obtaining cash immediately is worth the extra cost—or whether it is advisable to wait until money can be saved. The cost of credit may cancel a "bargain."
- **It may result in loss of merchandise or income.** If payments are not made on schedule, the credit user runs the risk of losing the merchandise. When credit requires collateral, default may result in the loss of income and valuable property.

Cost of Credit

When you buy consumer goods, you not only pay for the raw materials in the item purchased, but for the costs involved in producing, distributing and selling that merchandise as well. These costs may include research and development, workmanship and design, labor and equipment, shipping and transportation, guarantees and warranties, advertising, selling and general administration. For a business to be successful, the prices set for merchandise must cover these expenses and provide a reasonable profit.

Merchants and lending institutions extending credit to consumers also must provide a number of services necessary to do business. Credit charges are the income out of which a creditor must pay for these services and make a return on his investment. The cost of credit to the consumer is related to the creditor's cost of extending credit. Therefore, the price you pay must cover direct and indirect expenses such as:

- **the creditor's cost of money.** Just as merchants must obtain goods to sell, creditors must obtain money to lend or advance in credit. Banks, savings and loan associations and credit unions obtain money from savings deposits or the purchase of shares. Consumer finance companies generally borrow from other financial institutions. The rate charged for credit must bear a relation to the cost a creditor pays for the funds he lends.
- **opening accounts.** People, time and money are necessary to interview every customer who applies for credit and to verify the information given on credit applications.
- **record keeping.** Providing credit involves preparing initial documents and formal statements of credit transactions, receiving and recording payments made, and issuing receipts.
- **collection.** Certain expenses are involved with routine collection procedures—computing balances, making payment adjustments, etc. But extra time and costs are involved in handling credit losses and payments that become past due. Accounts that require legal action are especially costly.
- **overhead.** As in any industry, operating expenses such as rent, heat, light, air conditioning, telephone, supplies and administration are all a part of the costs incurred in doing business.



Credit rates differ widely according to the source of credit and the individual transaction. Some of the factors which influence the rate of charge include:

- **credit laws.** In the United States and Canada, credit rates are controlled by federal, state or provincial laws and are subject to varying degrees of regulation.
- **the amount of credit extended.** Many of the costs, such as checking the application, record keeping, collection, salaries and overhead, are about the same whether the amount

of credit is large or small. But the dollar cost is a higher percentage of the amount of credit extended for a small credit transaction than for a large one. Therefore, creditors who extend small amounts of credit are allowed to charge higher rates to cover higher costs.

- **the degree of risk involved.** All loans involve some risk, but the risk becomes greater as the possibility increases that the credit user will not meet his obligations fully or promptly. Creditors who extend credit to higher risk customers are permitted by law to charge more to cover higher investigation costs, extra expenses incurred in more collection work and higher losses. Conversely, creditors whose rate of charge is low (by choice or law), limit their credit to loans which they believe involve smaller collection expenses and a lower risk of loss.
- **the type of credit agreement.** Some creditors require certain forms of security, such as title to merchandise or the pledge of valuable collateral, to insure payment of a debt. Since the security covers the credit extended, creditors who require it often do not have to charge rates as high as those who depend solely on the ability and willingness of the customer to pay.
- **the type of purchase.** Credit rates vary according to the item serving as collateral. New-car rates tend to be lower than rates charged on furniture, household goods, and appliance purchases. Rates to finance new merchandise generally are lower than rates on used merchandise or nondurable goods.

Are You Credit Worthy?

Can you get a personal loan if you need it? Can you get a charge account if you want it? Your ability to get credit when and where you want it largely depends on your credit worthiness or your credit history.

Credit worthiness is measured by three factors. Frequently called the three Cs, they are: character, capital and capacity.

- **Character** is determined by your integrity in money matters. It is based on your honesty, reliability, willingness to pay, and your record of financial responsibility.
- **Capital** is measured by your financial resources, including equity in a home, household goods, automobile, life insurance and savings account.
- **Capacity** is judged by your earning power—present and future income—and your current financial commitments.

Generally, an interview, application or both are necessary each time you apply for credit from a different source. A creditor may ask such questions as:

- Where do you work . . . for how long . . . what kind of a job . . . how much do you earn?
- Where do you live . . . for how long . . . do you own or rent . . . where did you live previously?
- Do you have a checking account . . . a savings account? If so, where?
- Do you have other charge accounts . . . debts . . . loans? If so, where?

A creditor asks these questions largely to determine whether you can and will pay what you owe. Consumer credit is based on the creditor's trust in your ability and willingness to pay. That trust is established primarily by your past performance and earning capacity. That is why information about how you pay your bills, if you have a steady income and how much you earn is requested.

The **Equal Credit Opportunity Act*** in the U.S. makes it unlawful for creditors to deny credit strictly on the basis of sex, marital status, age, religion, race, national origin or because an individual receives income from public assistance. While it does not guarantee that you will be granted credit, creditors must base their decisions on your income, expenses and credit worthiness. Because this Act has had a profound effect on the ability of women to obtain credit, discrimination on the basis of sex and marital status will be discussed in the section *Women and Credit*. Yet other aspects of the Act are important and should not be ignored.

The section of the Equal Credit Opportunity Act dealing with discrimination based on race, national origin, religion, age and receipt of public assistance went into effect on March 23, 1977. It is unlawful for a creditor to arbitrarily deny credit on the basis of age, unless you are too young to sign a contract in your state. A creditor cannot ignore retirement income in rating an application; cannot require you to reapply, change the terms of your account or close it because you reach a certain age or retire; cannot deny credit or close an account because credit life insurance is not available to persons of retirement age; and cannot give those over 62 fewer points than those under 62 if using a scoring system to rate an applicant.

*Some Canadian provinces have passed similar legislation.

In addition, when evaluating the income of a credit applicant, a creditor must consider reliable income from public assistance in the same manner as other income; and cannot discount or refuse to consider part-time income or that derived from a pension, annuity or retirement benefit program.

The Act requires that you be notified within 30 days of applying for credit whether your application was accepted or rejected. If rejected, the creditor must give you specific reasons why (income too low, unable to verify employment, etc.), or must tell you that you have the right to such explanations within 60 days upon written request.

If you do not understand why you were rejected, discuss the reasons given with the creditor. Sometimes there is simply not enough information to make a sound judgment. If you feel you have been discriminated against, the state or federal agency you should contact depends on where you applied for credit. The appropriate agency and its address must be furnished by the creditor. While the Federal Trade Commission has overall enforcement responsibilities, they do not handle individual cases. For an overall view of the Act, see the chart on pages 36 and 37.

Establishing a Credit History

If you have no experience with credit, how do you establish yourself as a credit-worthy individual? What steps can you take to show creditors your willingness to pay for credit as agreed?

- **Open a checking and savings account.** Questions concerning checking and savings accounts are asked of every applicant. While this action alone does not make you credit worthy, it does indicate that you handle money in a businesslike manner. It is important that you do not overdraw your checking account. If you deposit a fixed amount in your savings account each pay period, not only will you be building an emergency fund or saving toward a major purchase, but regular payments to yourself indicate that you will most likely repay creditors in the same responsible manner. While credit bureau reports will not indicate that these savings "payments" have been made, showing your record of savings to creditors will.
- **Open a retail charge account.** These are the easiest to obtain. Use your charge card to make small purchases that you would have otherwise used cash to buy, and pay your bill promptly. If the bill is paid in full within the specified time, there is generally no finance charge.
- **Apply for a bank card.** These all-purpose credit cards are honored nationwide and in many foreign countries. You are given a limit on the amount you can charge, which increases as your income and credit history improve. You may also be charged an annual fee.

  Some banks also offer a line of credit on checking accounts, allowing you to write checks for amounts over your balance. You must pay a finance charge for this privilege, however, for it is considered a personal loan. For more information on these types of credit, see page 13.
- **Take out a small loan.** If you follow the preceding steps, you may be eligible for a small loan, if not a loan on an automobile. By depositing the loan in an interest-bearing account, some of your finance charges will be offset by the interest you earn. You may prefer to deposit the loan and withdraw as needed for monthly payments. After six months or so, you can pay off the loan in full, decreasing the total amount of dollars charged for obtaining the loan. By doing so, you establish yourself as a good credit risk, providing you do not have lot of other debts.

Credit Bureaus

Most lenders and retailers cannot afford the time or expense to verify all the information on every credit application. This has led to the formation of consumer credit reporting agencies, more commonly known as *credit bureaus*. Credit bureaus are essentially clearinghouses of consumer credit information. The records maintained by credit bureaus commonly concern basic identifying information, such as your name, address, employer, income and a listing of your bill-paying record. Most also include information concerning legal action against you which has an effect on your ability to meet financial obligations. Generally speaking, all this information makes up your *credit history* and that information, when distributed, is referred to as a *credit report*.

In the United States, the **Fair Credit Reporting Act** became effective April 24, 1971.* The purpose of this law is to insure that a credit report will contain accurate information, that this information will be used in a confidential manner, and that there will be no undue invasion of your right to privacy.

The law requires that if you are refused credit or the charge for credit is increased because of information obtained from a credit bureau, the credit grantor must inform you of the name and address of the credit bureau furnishing the report. Within thirty days of being denied credit because of information from a credit bureau, you may visit the bureau and, free of charge, review your credit history with a trained consumer interviewer. If you have not been denied credit or you have waited more than thirty days before requesting a review of your credit history, the credit bureau may charge you a small fee for the review.

*All Canadian provinces have passed similar legislation.

The credit bureau will recheck any entry you question. If it is found to be incorrect or cannot be verified, the entry will be deleted from your file. If information has been deleted because it cannot be verified, you may request that the credit bureau notify previous recipients of your credit history of that fact. Credit grantors who have received credit reports on you within the last six months must be notified, as well as those who have received reports for employment purposes within the last two years. If the reinvestigation does not resolve the question to your satisfaction, you may file a brief statement of your side of the story to be included with any future reports. Most adverse information—such as suits, judgments, arrest records, bad debts, etc.—can remain on record for seven years. Straight bankruptcies are reported for 10 years.

If you are refused credit or the charge for credit is increased, based on information obtained from sources *other* than a credit bureau, you must be told upon written request the nature of this information, but not necessarily the source. You must also be advised of your right to make such a request.

The law also covers *investigative consumer reports*, which consist of information on your character, reputation or general mode of living. Normally assembled by specialized investigative firms, this information is usually obtained by interviews with your neighbors, friends and associates and is used primarily by insurance companies and potential employers. The law requires that you be notified whenever a consumer reporting agency makes such an investigation, and that you be advised of your right to request information on the nature and scope of the investigation. (Credit bureaus, whose reports are confined to credit information, do not usually compile this kind of report, although some general employment information may overlap.)

Traditionally, credit accounts shared by a husband and wife were reported by the credit grantor to the credit bureau in the name of the husband only. This procedure effectively resulted in the establishment of a "joint file" that was carried only in the name of the husband. If death or divorce occurred, the wife, lacking a credit history, often had difficulty establishing credit in her own name. As of June 1, 1977, the **Equal Credit Opportunity Act** required that if you choose to open a joint account, it must be reported under both names, not just the one appearing on the charge card or billing statement. While both good and bad reports will appear in both files, if you can prove to a credit grantor that adverse information does not accurately reflect your ability or willingness to repay, the creditor must disregard the unfavorable information. This provision is particularly important in divorce situations or where one spouse handles credit irresponsibly.

Credit bureaus only keep records—they do not make them. Nor do they make the decision whether or not credit will be granted to you. Credit bureaus simply report information to credit grantors. The credit grantor will then give you a *credit rating* by applying certain criteria to your credit history as shown on your credit application and the bureau report. The criteria will differ among the various lending institutions and retailers, as well as from one part of the country to another.

To build and protect a good credit history:

- be truthful when applying for credit;
- use credit only in amounts that you can repay safely;
- fulfill all terms of a credit agreement;
- pay promptly; and
- consult creditors immediately if you cannot meet payments as agreed.

12

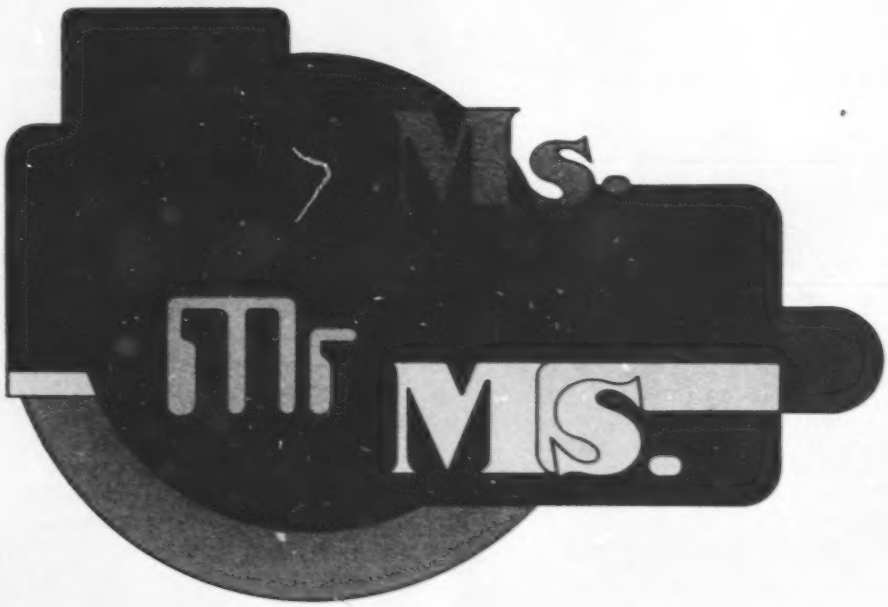
Women and Credit

The world of the American woman is changing. Many of these changes have to do with lifestyle decisions. Women are marrying later or not at all. Couples are having fewer children or are remaining childless. In terms of numbers, women are taking the work world by storm—out of choice or necessity. And women's attitudes about themselves and what they can do are improving as their options increase.

If all women married and lived happily ever after, legislation concerning women and credit would probably not have been necessary. But much as one would like to ignore unpleasant facts, over 11% of today's women are divorced or separated, and almost 13% are widowed. Very often these women not only lose a husband, but an income, a credit rating and the independence that goes with them as well. These changes in marital status usually mean a change in lifestyle—living alone or raising children alone, going to work, etc.—and often result in an abrupt change in financial status. By having previously established her own credit history, a woman will at least have the security of knowing credit is available if and when it is needed.

Whether you are a Miss, Mrs. or Ms., you now have the right to apply for credit in your own name and based on your own credit worthiness. As of October 28, 1975, the **Equal Credit Opportunity Act** has prohibited discrimination against a credit applicant based on sex and marital status. This does not mean that you will automatically be granted credit because you are a woman. It does mean that the same standards of credit worthiness are applied to all credit applicants.

How can you be sure you are getting credit where credit is due? While the steps outlined in the above section, *Establishing a Credit History*, hold true for everyone, there are some additional steps women can take.



Use your own name when applying for credit. Single women would of course use their given name; for instance, Sarah Ann Smith or Sarah Smith. Married women have more choices. Suppose Sarah Ann Smith married Michael Adams and decided to take his last name. She could choose Sarah Ann Adams, Sarah Adams, Sarah Smith Adams or Sarah Ann Smith Adams as her legal name. Sarah could also decide to continue using her maiden name on credit applications. Any of these six names are legal as long as you select one, use it consistently and there is no intent to fraud. *Do not use your social title*—Mrs. Michael Adams. It is not your legal name and could be held by a number of women. In addition, any credit information under this name would go in your husband's credit file and would not benefit you.

Make sure current charge accounts being reported to the credit bureau also include your name. (If your husband has a good credit history, that is!) While joint credit accounts opened after June 1, 1977, are automatically reported under both your name and your husband's, accounts opened prior to that date may not be included in your credit history. To insure that all accounts be included in a separate credit history, write to your creditors (a form letter will do) requesting that credit information also be reported in your name. Include in the letter your husband's name as it appears on the billing statement, your address, the account number and your name as it should appear on the credit file.

If you have recently married and have changed names, just write to your creditors informing them of the change and your wish to retain a credit file separate from your husband's. Also mention the fact that you are as credit worthy as before.

When applying for credit, creditors *may not*:

- ask your sex.
- ask your marital status on an application for an individual, unsecured account (a retail charge account, for example), unless you live in a community property state.* You can be asked whether you are married, unmarried (includes single, widowed or divorced) or separated if you are applying for a joint account. However, you are not required to choose a courtesy title (Miss, Mrs. or Ms.) on a credit form.
- ask for information about your husband or ex-husband, unless 1) you live in a community property state; 2) you are relying on his income or income from alimony; or 3) he will use the account or be responsible for it.
- require a cosigner or your husband's signature just because you are a woman or married.
- require you to reapply for credit, change the terms of your account or close it because your marital status changes. A creditor may ask you to reapply if there is some indication that you are no longer willing or able to repay a debt, or if your ex-husband's income was counted to support your credit.

In deciding whether or not you are credit worthy, a creditor *may not*:

- discount or refuse to consider your income because you are married, are of child-bearing age, or your income is from part-time employment.
- ask about your birth control practices or plans to have children. In order to estimate your expenses, however, a creditor may ask the number and ages of your children.
- refuse to consider alimony, child support or separate maintenance payments if you choose to include them as a source of income. In order to evaluate these payments as a dependable source of income, a creditor may ask how regularly they are received and whether they are made under court order. Creditors may also ask whether you must *make* these payments.
- consider whether or not you have a telephone listing in your own name.

As with the provisions of the Equal Credit Opportunity Act discussed above regarding discrimination based on age, religion, race, national origin or receipt of public assistance, creditors must notify you within 30 days of their decision concerning your application. The same procedures also apply if you feel you have been discriminated against. Under the **Fair Credit Reporting Act**, you also have the right to inspect your credit file and check for its accuracy, as outlined in the section, *Credit Bureaus*.

Take advantage of these new laws that aid the credit consumer, and prove to yourself—and your creditors—that you are a financially responsible *person*.

*Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington

Comparing Credit Charges

Many different methods for stating and computing finance charges have developed over the years.* Since these variations made it difficult to understand and compare credit costs, consumers often paid little attention to the credit terms. If the down payment and the monthly payment were affordable, the customer frequently accepted the terms without realizing that credit costs differ or without considering alternative sources of credit.

In the United States, Titles I and II of the federal **Consumer Credit Protection Act**, commonly known as **Truth in Lending** or Regulation Z, became effective July 1, 1969. Each Canadian province has a similar law. The Truth in Lending Act requires that all lenders and retail merchants provide certain information to credit customers *before* credit is extended. As of October 1, 1982, disclosures for closed-end credit (installment credit) must appear apart from all other information. Two of the most important disclosure requirements are that the finance charge must be stated both in terms of:

- the dollar amount, and
- the annual percentage rate.

The finance charge as a **dollar amount** tells you at a glance how much you are paying for credit if you pay on time. It is the total of all charges for obtaining credit, such as interest, loan fees, service or carrying charges, investigation fees, and premiums for credit life or other insurance. (Insurance may be excluded if it is not required from the creditor and certain disclosures are made.) The dollar amount is generally more meaningful if you compare the same amount of credit borrowed over the same period of time. As consumers we make most of our buying decisions in terms of dol-

*For information on methods of computing credit charges, refer to the Appendix, pages 40-43.

lars and cents—we earn a dollar income, we spend dollars to obtain goods and services. It is on the basis of dollar cost that we must decide what we can buy and how much we can afford to spend on various goods and services— including credit.

The **annual percentage rate** (APR) is the cost of credit in percentage terms. It is the ratio of the dollar finance charge to the average amount of credit in use during the life of the contract. It is expressed as a yearly percentage. For example, suppose you borrow $100 for one year and pay $11 in finance charges for that money. If you repay the loan in full at the end of the year and have use of the entire amount for that time, you are paying an annual percentage rate of 11%. But if you repay the loan in 12 equal monthly installments, over the entire year you have the use of only about half of the total $100 on the average. So the $11 charge for credit in this case becomes an annual percentage rate of about 22%. While the finance charge in both cases is the same ($11), the annual percentage rate differs dramatically. This is why it is important to have both figures at hand when shopping for credit.

The annual percentage rate makes it easier to compare costs between lenders, particularly if you vary the amount of the loan and the time you wish to have it. It also helps you to compare the cost of credit with the rate of return on savings and investments which might be used as an alternative.

Disclosure of the dollar cost and annual percentage rate helps you to answer two important questions concerning the use of credit: Can you afford to use credit? and, Which source of credit offers the most advantageous terms?

While other terms must be disclosed under the Truth in Lending Act, they will be discussed in detail in the sections *Consumer Credit Agreements* and *Shopping for Credit*.

Types of Consumer Credit

Where you obtain credit will depend on the amount you need, your credit history, the purpose for which you want it, the value and type of security you can offer, and the services you require.

Basically, all consumer credit transactions can be classified as one of two types of credit.

- **Sales credit** is extended in connection with the purchase of merchandise or services. It is offered by department stores, furniture or appliance dealers, automobile agencies, contractors, repairmen and other sellers of goods and services.
- **Cash credit** is extended to individuals in the form of money. It is provided through certain credit cards, lending agencies and other financial institutions.

In turn, each type of consumer credit can be classified into one of two categories, based upon the method of repayment.

- **Non-installment credit** is single payment credit. It is used for some types of charge accounts, utility bills, repair bills, professional services such as doctor bills, and single payment cash loans.
- **Installment credit** is repaid in a series of payments, ranging from a few weeks or months to several years. It is used primarily for major purchases and cash loans.

When You Purchase

Originally, charge accounts were extended to a privileged few as a convenience—permitting the customer to make a single payment covering numerous purchases during a specific period of time. But merchants have found that credit is not only a convenient way for customers to pay for purchases, it also increases sales.

Many retailers believe that a credit customer purchases more frequently and that he continues to do business where he has established credit. Consequently, merchants are more willing to extend larger amounts of credit over longer periods of time. Today, the majority of customers at most stores can charge their purchases or buy on some form of credit plan.

Most major department stores and large specialty shops offer their own credit plans. Many others participate in credit programs sponsored by banks, credit card agencies or other financial organizations.

Outlined below are the three types of sales credit most commonly used and their principal characteristics.

Regular or 30-day charge accounts are used mostly for convenience in handling routine or everyday expenses. This type of credit is basically the same as paying cash since it requires your promise to pay in full within 10 to 30 days after the billing date. Customarily, there is no finance charge if the bill is paid in full within the time period.

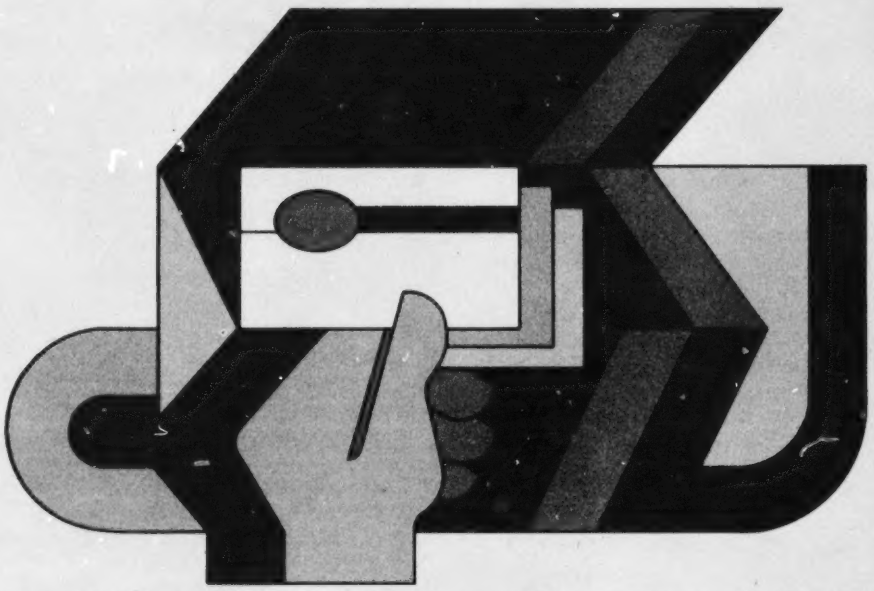
Revolving or open-end charge accounts allow you to make repeated purchases up to a set limit established by the creditor when the account is opened. This type of credit plan is particularly convenient at peak buying periods, as you may either pay in full when billed or elect to pay only a portion of the balance. You can continue

to make purchases as long as the amount owed does not exceed the established limit and payments are made according to the agreed terms.

A finance charge usually is made on the unpaid balance. Retail creditors are not able to state dollar finance charges in advance for revolving or open-end charge plans. Since charges are computed on the unpaid balance, they will depend on how much credit is used and how quickly it is repaid. However, retailers must state the applicable periodic rate used in calculating the charge and the annual percentage rate. Charges computed at 1, 1½ or 2 percent monthly amount to 12, 18 or 24 percent when stated as an annual percentage rate. Some creditors determine the finance charge by applying a monthly rate to the opening unpaid balance. Others apply the monthly rate to the average daily balance. Or creditors may apply the rate to the opening balance minus any payments that are made during the month.

Under some credit agreements, a regular or 30-day charge account may automatically become a revolving account if the full amount is not paid within the specified time period.

Installment purchases or closed-end payment plans usually involve a written agreement for each credit purchase. A down payment or trade-in may be required, with the balance to be repaid in equal installments over a period of time. Generally, the seller holds title to the merchandise until payments are completed. This type of credit is used primarily to purchase major goods and services which are needed or desired immediately, with payments budgeted over a period of time. Finance charges vary according to the amount financed, the length of the repayment period, and the item serving as collateral. Charges typically range from 12 to 36 percent when stated as an annual percentage rate.



Generally, the more expensive the item being purchased, the longer the term of the contract and the lower the rate.

The "badge" which enables you to make purchases on your charge account is the *credit card*. It acknowledges that your credit will be honored by the issuer, usually up to a predetermined amount. Most credit card issuers offer credit plans similar to the 30-day or revolving charge accounts. You are billed monthly and a finance charge usually is made on the unpaid balance. In addition, some credit card agencies require a membership charge or an annual fee.

You will receive a monthly statement that records the credit transactions occuring during your billing period. The statement will list such items as the amount owed at the beginning of the billing period; the date and amount of a purchase and its description; amounts credited to your account for returns or payments; any finance charge and the balance on which it was figured; the periodic rate used to compute the finance charge and the annual percentage rate; the closing date, the unpaid balance on that date and the date by which you must pay that amount to avoid additional finance charges; and the address where written notice of a billing error may be sent.

Compare your charge receipts with the billing statement each month. Make sure all purchases and credits are listed. If they were made after the closing date on the account, they will be listed on the following month's statement.

The **Fair Credit Billing Act** in the U.S., effective October 28, 1975, helps consumers correct errors which may appear on their billing statements, such as:

- charges you did not make or those made by an unauthorized person;
- charges listing the wrong price, description or date;
- charges for goods or services you didn't accept or were not delivered as agreed;
- failure to credit your account for returned items or a payment;
- accounting errors—arithmetic mis-

takes in figuring the finance charge, for example;
- billing for which you request an explanation or written proof of purchase; and
- failure to mail or deliver the statement to your current address, provided you have given them 10 days notice of the address change prior to the closing date on your account.

Creditors are required to send you a written notice every six months, informing you of your rights under the Act and the procedures to follow if there is an error in your bill. As the notices sent by each creditor are the same except for their names and addresses, keep a copy on hand in case you have a problem. The notice is titled, "In Case of Errors or Inquiries About Your Bill." Its highlights?

- You have 60 days from the date you receive your statement to notify a creditor *in writing* about an error in your bill. While a simple phone call may solve the problem, it will not protect your rights under the law. Do not write on the billing statement. In a separate letter, state your name, the account number, the dollar amount in dispute and an explanation of why you think the bill contains an error. Retain a copy of the letter for your files. If you wish to include receipts, cancelled checks, etc., send copies—never the originals.
- The creditor must acknowledge your letter within 30 days of receipt, unless the error can be corrected within that time. Within 90 days of receiving your letter, the creditor must correct the error or explain why he believes the bill is correct.
- If you are not satisfied with the creditor's explanation, notify him within 10 days of receiving the explanation that you still refuse to pay the disputed amount. Although the creditor may try to collect the amount, any reports to credit bureaus about your refusal to pay must show that it was due to a billing dispute.
- While this procedure is going on, you do not have to pay the disputed amount of money or any finance charges based on that amount. *You are still responsible for paying any amounts that are not in dispute.*

If you have a problem with goods or services purchased with a credit card, and have made an effort to return them or given the merchant the chance to correct the problem, you have the right not to pay the remaining amount due. There are two limitations on this right: 1) you must have made the purchase in your home state or within 100 miles of your current address; and 2) the purchase price must be over $50. If the creditor is the same firm that issued or honored your card, or if the creditor mailed you an advertisement for the goods or services, these limitations do not apply.

If a creditor fails to reply to your letter within the required time period or otherwise violates your rights under the law, he forfeits the amount of money in dispute, up to $50, and any finance charges computed on the amount. This happens whether or not there actually was a billing error.

Considering the vast number of credit card transactions which occur each month, the number of billing errors is quite small. This is not much consolation when it happens to *you*, but by exercising your rights under the Fair Credit Billing Act, and by following the procedures set forth, the unfortunate experience can be made somewhat less frustrating.

Credit cards are very valuable pieces of plastic. Guard your cards as carefully as you would cash. Destroy unwanted cards and maintain a list of the account numbers of the ones you have. If your credit cards are lost or stolen, contact your creditors immediately—first by phone, then with a follow-up letter (a form letter will do). If you notify the card issuer before it is used fraudulently, you will not be liable for any charges made upon it. A notice is effective the date it is postmarked. In addition, if the issuer has not informed you of your potential liability or provided the necessary information for reporting a lost or stolen card, there is no liability.

The **Truth in Lending Act** limits a cardholder's liability to a maximum of $50 a card. If you discover yourself liable for unauthorized use of your cards, you may be covered under your tenant's or homeowner's insurance policy. It would be worth a call to your agent to find out.

Since January 25, 1971, the Act has prohibited the mailing of unrequested credit cards, except for new or renewed versions of the ones you currently use. In Canada, some provinces have legislation stating that consumers are not responsible for unrequested merchandise or credit cards unless their receipt is acknowledged in writing. Other provinces ban the mailing of unrequested cards altogether.

Credit cards are not a way to live beyond your means—the bills will eventually come due. It is so easy to say "charge it," that you may be shocked when the bills arrive. To avoid such unwelcome surprises, there are several steps you might take.

- Keep a running total of the amounts you charge—and don't go over the amount you had planned to spend.
- Carry just the cards you will need for a particular buying trip.
- If you don't need anything, stay out of the stores.
- Don't shop when depressed—you'll be even more upset when the bills come in.
- Skip over tempting ads; throw out special flyers, etc.
- Curb impulse purchases—look, admire, but do not touch.
- If you are a "credit-holic," cut up your cards and deal strictly in cash.

Sales Finance Agencies

Many retailers such as automobile dealers, appliance and furniture dealers, and other merchants who sell expensive goods and services, cannot afford to tie up their working capital in long-term installment contracts. Therefore, they may sell them to a bank or a sales finance company.

Usually, the financing institution will notify you that it has purchased the contract and will provide information about repayment. You then become responsible to the financial institution —the seller is no longer involved in financial matters.

Before signing an installment contract for goods or services, find out who will own it eventually and the seller's policies regarding defective merchandise, servicing, repairs, warranties and refunds. Although the seller is the one from whom the buyer would first seek proper settlement, a U.S. Federal Trade Commission rule, called **Preservation of Consumers' Claims and Defenses**, states that the financing institution cannot insist that it be paid if the goods are defective or the services not rendered as promised. Before ceasing payments, however, call or write the financing institution to explain the situation. They will most likely contact the seller and intervene in your behalf.

In Canada, amendments to the federal **Bills of Exchange Act** legislate similar consumer protection. The provinces have also passed legislation that provides similar protection regarding other types of installment contracts that come within provincial jurisdiction.

When You Borrow

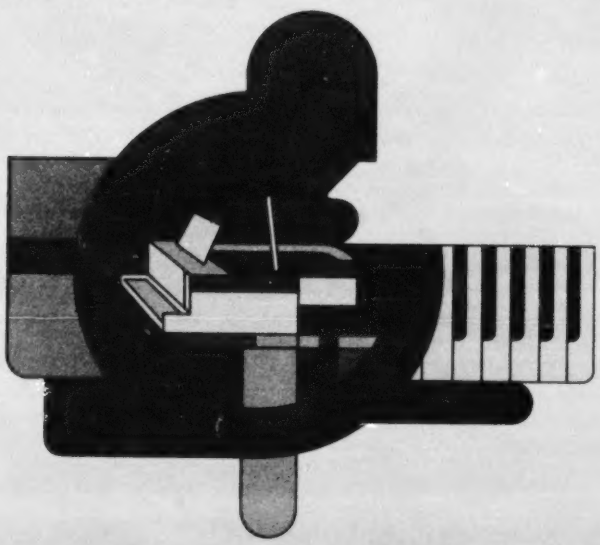
Consumer loans are used for many reasons—most often to obtain goods and services that require a large cash outlay, to meet emergencies or to pay off accumulated debts. The forms of cash credit generally used are explained below.

Personal installment loans most frequently meet the needs of the majority of borrowers since they are repaid in weekly or monthly installments over a period of time. Some installment loans require only your signature as a promise to pay; others require the pledge of some form of valuable property as collateral. With passbook or savings account loans, your savings, up to the amount you borrow, is used as collateral. While these funds cannot be withdrawn until the loan is repaid, they do continue to earn interest, making the effective interest rate of the loan lower. Finance charges vary according to the lender, the size of the loan, the time period, and the security offered.

Single payment loans can be arranged for a large or small amount of money. In either case, you agree to repay the entire amount in one single payment on demand or after a specified period of time—usually 30, 60 or 90 days. Single payment loans almost always require some form of valuable security. Passbook or savings account loans may also be arranged as a single payment loan. Finance charges vary according to the lender, the size of the loan, the time period and the security offered.

Check-credit plans, offered by banks, and **share draft-credit plans**, offered by credit unions, are similar to revolving charge accounts. They require an agreement between you and the lender establishing a maximum credit limit and a repayment schedule for monthly installments. You then may write checks (on a special check form) against your credit limit as long as the amount owed does not exceed the limit and payments are made on schedule. Such plans may provide automatic overdraft protection. If you write a check for more than you have in your checking account, the lender will advance the funds—often in increments of $50 or $100—up to your credit limit. A finance charge on the outstanding balance is made monthly, and in some instances, a fee for each check written.

Cash advances, using a national credit card, operate much like check-credit plans. Using the checks distributed by the card company, you may obtain a cash loan up to your credit



limit. The amount will be included on your billing statement and finance charges generally will be levied at the same rate as any other card purchase.

Second mortgages, called **collateral mortgages** in Canada, are becoming increasingly popular. As inflation and other factors push the market value of most homes upward, homeowner's equity—the difference between the existing mortgage and the market value—becomes a valuable asset and source of cash. Why obtain a second mortgage? Reasons may include financing the children's education, making major home improvements, purchasing a second home or motor home—all investments which require a significant amount of cash and which may increase in value over time. Second mortgages are not to be taken lightly. Because your home is security for the loan, the reason for borrowing should be thought through carefully. For instance, a loan for an automobile, a vacation or to consolidate bills might more wisely be met by a personal installment loan.

Banks, consumer finance companies, industrial banks, savings and loan associations and credit unions may offer second mortgages ranging from 70 to 85 percent of the amount of equity in your home. In the U.S. repayment periods generally range from 36 to 180 months. In Canada repayment may extend up to ten years. While the annual percentage rate varies with the size of the loan and the length of time it will be outstanding, in the long run second mortgages can be substantially less expensive than refinancing an existing mortgage at today's interest rates.*

When you enter a credit agreement using your home as security, the **Truth in Lending Act** gives you three business days to cancel the agreement if you change your mind for some reason. The creditor is required to give you written notice of this right to cancel and the name and address of whom to contact if you choose to do so. If you wish to cancel an agreement, contact the creditor *in writing* within the time allowed. The creditor has 10 days from the receipt of your notice to refund any down payment. You may waive your right to cancel by notifying the creditor in writing that there is a financial emergency and you need credit immediately to avoid damage to yourself, your family or property—for example, needing a new roof put on immediately to avoid structural damage to your home.

*For more information on first and second mortgages, refer to YOUR HOUSING DOLLAR, listed inside the back cover.

Sources of Cash Credit

There are a number of institutions that lend money, but the primary sources of consumer loans are commercial banks, consumer finance companies, credit unions, insurance companies and savings and loan associations.

Commercial banks are the largest single source of consumer credit. They offer a variety of consumer credit plans as a part of their overall banking operation.

Consumer finance companies make personal installment loans as their primary business. They operate under the small loan and similar laws in each state or province.

Credit unions are nonprofit cooperatives composed of people who share some common bond. For example, they may work for the same employer, belong to the same labor union, or attend the same school. While accepting savings and extending consumer loans are a major function of credit unions, they offer a variety of other financial services.

Life insurance companies, frequently overlooked as a source of consumer loans, will lend the cash value on a life insurance policy. However, policy benefits are reduced by the amount of the loan if death occurs before repayment.

Savings and loan associations concentrate on housing-related consumer loans, typically home improvement or second mortgage loans. Savings associations, however, are also sources of educational and savings account loans, and may offer a full range of consumer loan services.

In addition to the major lending sources, industrial banks, originally formed to lend money to industrial wage earners, operate in some states. Today, however, most industrial banks have been converted into commercial banks. Industrial loan companies, formed for the same purpose, generally make larger loans than authorized under the small loan laws.

Pawnshops lend cash on items which have resale value, such as jewelry, musical instruments, and other articles, which the borrower leaves with the pawnbroker as security. Pawnshops frequently deal in small loans which other lending sources would not consider.

Where you go to borrow money and how much you pay for it will depend on the amount you wish to borrow, for what purpose, your credit history and any additional services you require. There is no one source of cash credit that is best for every individual; conditions among borrowers and lenders vary too much. To provide society with consumer loan service to meet all of its needs, each lending institution has a specific role. For instance, credit unions lend to members only . . . not all borrowers can qualify for a bank loan . . . customers who want only a small loan or who present a higher degree of risk may be best served by a consumer finance company . . . others who cannot establish credit at any of these institutions must seek help from the pawnshop.

Sources of Consumer Credit

The following table outlines the major sources of consumer loans. The attempt has been made to generalize the information and to give an average picture of each source in regard to the type of credit available, lending policies, costs and customer services. Because of dramatic fluctuations in interest rates during the 80s, it is difficult to give a specific range of annual percentage rates. Furthermore, regulations and laws differ from state to state and province to province.

Study and compare the differences to determine which source can best meet your needs and requirements.

Credit Source	Commercial Banks	Consumer Finance Companies
Type of Loan	• single payment loans • personal installment loans • passbook loans • check-credit plans • credit card loans • second mortgages	• personal installment loans • second mortgages
Lending Policies	• seek customers with established credit history • often require collateral or security • prefer to deal in large loans such as auto, home improvement and modernization, with the exception of credit card and check-credit plans • determine repayment schedules according to the purpose of the loan • vary credit rates according to the type of credit, time period, customer's credit history and the security offered • may require several days to process a new credit application	• often lend to consumers without established credit history • often make unsecured loans • often vary rates according to the size of the loan balance • offer a variety of repayment schedules • make a higher percentage of small loans than other lenders • maximum loan size limited by law • process applications quickly, frequently the same day as the application is made
Cost	lower than some lenders because they: • take fewer credit risks • lend depositors' money which is a relatively inexpensive source of funds • deal primarily in large loans which yield a larger dollar income without an increase in administrative costs	higher than some lenders because they: • take greater risks • must borrow and pay interest on money to lend • deal frequently in small loans which are costly to make and yield a small amount of income
Common Range of Annual Percentage Rates*	• 15%-21% credit card and check-credit plans • 16%-24% unsecured loans (in Canada, rates vary; based on Bank of Canada) • 8½%-13½% secured loans and passbook loans • 15%-18% second mortgages (in the U.S., regulated by national and state banking laws; in Canada, there are no legal restrictions on bank rates)	• 18%-36% personal loans (depending on the size of the loan and state or provincial laws; in Canada, generally from 21%-30%) • 18%-22% second mortgages
Services	• offer several different types of consumer credit plans • may offer financial counseling • handle credit transactions confidentially	• provide credit promptly • make loans to pay off accumulated debts willingly • design repayment schedules to fit the borrower's income • usually offer financial counseling • handle credit transactions confidentially

*Rates applicable at date of printing.

	Credit Unions	Life Insurance Companies	Savings and Loan Associations
	• personal installment loans • share draft-credit plans • credit card loans • second mortgages	• single or partial payment loans	• personal installment loans (generally permitted by state-chartered savings associations) • home improvement loans • education loans • savings account loans • second mortgages
	• lend to members only • make unsecured loans • may require collateral or cosigner for loans over a specified amount • may require payroll deductions to pay off loan • may submit large loan applications to a committee of members for approval • offer a variety of repayment schedules	• lend on cash value of life insurance policy • no date or penalty on repayment • deduct amount owed from the value of policy benefit if death or other maturity occurs before repayment	• will lend to all credit-worthy individuals • often require collateral • loan rates vary, depending on size of loan, length of payment and security involved
	lower than some lenders because they: • take fewer credit risks • lend money deposited by members which is less expensive than borrowed money • often receive free office space and supplies from the sponsoring organization • are managed by members whose services, in most cases, are donated • enjoy federal income tax exemptions	lower than some lenders because they: • take no risk • pay no collection costs • secure loans by cash value of policy	lower than some lenders because they: • lend depositors' money, which is a relatively inexpensive source of funds • secure most loans by savings accounts or real estate
	• 9%-15% (limited to 21% under federal and most state credit union laws, but may be higher in some Canadian provinces)	• 5%-8% (as stated in the policy)	• 7¼%-21% savings account and other secured loans • 17%-20% second mortgages
	• design repayment schedules to fit the borrower's income • generally provide credit life insurance without extra charge • may offer financial counseling • handle credit transactions confidentially	• permit repayment at any time • handle credit transactions confidentially	• often offer financial counseling • specialize in mortgages and other housing-related loans • handle credit transactions confidentially

Consumer Credit Agreements

The use of consumer credit almost always involves a written credit agreement which states the rights of both the creditor and the credit user. The form of agreement depends on the credit source and the type and amount of credit extended.

Types of Credit Agreements

Regular and revolving charge accounts involve a basic agreement which is signed when the account is opened. It covers all credit purchases and cash advances, and remains the binding agreement as long as the account is continued. Generally, the agreement will state the following:

- the time in which you have to pay a bill before incurring a finance charge;
- the minimum amount due on the account and the consequences if you fail to pay it;
- the finance charge, how it is computed and the conditions under which finance charges will not be assessed;
- the annual percentage rate; and
- permission for the creditor to obtain information on your credit record.

Credit transactions, such as installment purchases and cash loans paid over a longer period of time, normally require a written agreement for each purchase or transaction. There are two basic types.

- **The Retail Installment Contract and Security Agreement** (sometimes referred to as a conditional sales contract) is usually required for installment purchases. It is an agreement between you and the seller which allows you to obtain merchandise at the time of purchase. If you fail to fulfill all terms as agreed, the seller may have the legal right to demand immediate payment in full or to repossess the merchandise if this right is specified in the agreement.
- **The Promissory Note** is used by banks, savings and loan associations, consumer finance companies and credit unions. It is a signed agreement between you and the lender which acknowledges a cash loan and states the conditions for repayment. If you fail to fulfill the terms of the agreement, the lender has the legal right to force payment by court order within the limits of your income and property.

A credit agreement may be an *unsecured* agreement in which evidence to pay is based only on the credit user's character, ability and willingness to pay, or it may be a *secured* agreement which requires the pledge of valuable property or some other form of security. The pledged security creates a legal obligation which helps to enforce the terms of the agreement and to insure payment of the debt.

The Security Agreement itself is an instrument that gives the creditor a security interest in the personal property that it covers, such as an automobile or household goods. If the debt is not paid according to the terms of the agreement, in many cases the creditor has the right to repossess the property. A creditor may also require other types of security, such as negotiable stocks, bonds, savings or life insurance policies. If the debtor fails to pay according to the terms of the note, the creditor has a right to sell the collateral and apply the proceeds to the payment of the debt.

The contract on page 22 is a combined promissory note and security agreement. While every contract will not look exactly like this one (they vary somewhat according to state and provincial laws and to lender), it does highlight some important terms which will affect your relationship with the lender. A credit agreement provides protection for both you and the creditor. If either fails to carry out his part of the agreement, the other may take legal action to enforce the terms of the contract.

Before You Sign

Before signing any credit agreement, it is important to read it carefully. Don't rush! Take enough time to fully understand every term. As creditors move toward contracts stated in simple English, this will be easier to do, but ask questions if there is something you do not understand. Be sure that all statements in the contract are clear and complete . . . that dates, dollar costs, and the annual percentage rate are correct and properly entered . . . that there are no blank spaces to be filled in later.

You should be able to tell from reading the agreement what action the creditor can take if you pay late, miss a payment or fail to complete payments. Find out too whether you will be permitted to pay in advance without penalty and whether you will receive a refund of credit charges on the amount prepaid.

Finally, pay only the charges entered in the contract. If the lender or retailer should ask for money for additional fees or services not stated in writing, do not pay them.

According to the **Truth in Lending Act**, the following information must be clearly stated on every credit contract:

- the amount financed
- the total number of payments and their amounts
- the finance charge expressed as a dollar amount
- the finance charge expressed as an annual percentage rate
- the date on which the finance charge begins to apply, if different from the date of transaction

- an itemized list of all charges not included as a part of the finance charge
- the number, amounts and due dates of payments
- the charges for late payment or default
- a description of any security held by the creditor
- a statement of any finance charge refund for prepayment
- a description of any prepayment penalty

Creditors must provide this additional information in contracts for the purchase of merchandise on time:

- a description of the merchandise
- the cash price
- the deferred payment price
- the down payment, including trade-in

Creditors depend on prompt payments for successful operation. They do not welcome the problems involved in collection of past due accounts or repossession of merchandise. They also want to avoid the ill will associated with legal action to force payment. Therefore, a reputable lender or retailer will try to limit credit within your ability to repay. In turn, certainly you do not want to lose merchandise purchased, money invested in payments, valuable collateral pledged, or of greater importance, a good name and credit history. Therefore, it is to your advantage to meet all terms of any agreement you sign.

To protect your own interests, fulfill your responsibilities in using credit and deal *only* with lenders and sellers who take their responsibilities in granting credit seriously. While irresponsible and disreputable creditors are in the minority, they do exist. If you become the victim of a loan shark or a dishonest merchant or creditor, you can and should:

- **Report illegal and unfair practices to local, state, provincial or national officials or agencies concerned with consumer rights and protection.** In the U.S. these include the Better Business Bureau, the Chamber of Commerce, your state Bureau of Consumer Frauds, your district attorney or state's Attorney General, the Office of Consumer Affairs, the Federal Trade Commission and/or the agency which oversees the creditor in question. In Canada, contact the provincial offices of the Chamber of Commerce, the Consumer Protection Bureaus Association, the Department of Consumer and Corporate Affairs, and/or the nearest Better Business Bureau. Several of these addresses are listed on page 35; others can usually be found in your local telephone directory.
- **Seek professional advice concerning legal action that may be taken against unlawful practices of creditors.** The local Legal Aid Society, the Small Claims Court, or an attorney can assist you in protecting and enforcing your legal rights.

Your Responsibilities as a Credit User

- to consider your overall financial situation and ability to repay before signing a credit agreement
- to read and understand a credit contract carefully before signing it
- to be fully aware of your obligations in signing any credit agreement
- to pay promptly according to the terms of the contract
- to notify the creditor promptly in case of a billing error
- to notify the creditor if, for any reason, you cannot meet scheduled payments
- to pay the penalty specified in the contract for late payments
- to accept the consequences outlined in the contract for failure to fulfill obligations

Responsibilities of the Creditor

- to investigate the credit customer's ability and willingness to repay before extending credit
- to state credit terms clearly and accurately
- to conform to laws regulating the granting of credit
- to write in all credit terms before the contract is signed
- to present the credit customer with a copy of the contract
- to correct billing errors promptly
- to accept advance payment and credit the customer with the portion of credit charges applicable to the amount and period prepaid
- to pass on to the customer any excess of the amount owed after repossession and sale of property or collateral

RETAIL INSTALLMENT CONTRACT AND SECURITY AGREEMENT (Goods)

Date _____, 19 ____

SELLER (CALLED "YOU")

NAME _____

ADDRESS _____

CITY _____ STATE _____ ZIP _____

SALESMAN _____

BUYER(S) (CALLED "I")

NAME _____

NAME _____

ADDRESS _____

CITY _____ STATE _____ ZIP _____

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	Amount Financed	Total of Payments	Total Sale Price
The cost of my credit as a yearly rate.	The dollar amount the credit will cost me.	The amount of credit provided to me or on my behalf.	The amount I will have paid after I have made all payments as scheduled.	The total cost of my purchase on credit, including my downpayment of $ _____
%	$	$	$	$

My payment schedule will be:

Number of Payments	Amount of Payments	When Payments Are Due
		, 19 and same date of each following month

Security: I give you a security interest in the goods or property being purchased.

Late Charge: If I don't pay any payment in 10 days after it's due, I shall also pay 5% of that payment, but not over $5.00.

Prepayment: If I pay off early, I may be entitled to a refund of part of the finance charge.

See the contract document for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds.

DESCRIPTION OF GOODS	MANUFACTURER	MODEL NO.	SERIAL NO.	CASH SALE PRICE
				$
				$

INSURANCE DISCLOSURE

NO INSURANCE IS REQUIRED FOR THIS SALE. I may buy any insurance from anyone I choose. Only if requested and for cost stated below, you or buyer of this contract will obtain insurance. Charges will be included in the Amount Financed. I **understand this is the only insurance you offer and you (or buyer of this contract) expect to profit from its sale. I consent to this.** The one Buyer signing this Insurance Disclosure will be insured when coverage begins, unless a different Buyer's name appears here:

_____

(WRITE "YES" OR "NO" AS DESIRED, DATE, AND SIGN. IF NONE DESIRED, SIGN BELOW.)

_____ Credit Life* ..... $ _____

_____ Credit Disability* ..... $ _____

_____ Property Insurance ..... $ _____

(fire, burglary by forcible entry ($100 ded.), est. cov. replacement value, not over Total of Payments)

_____ _____

DATE SIGNATURE

NO INSURANCE DESIRED: _____

SIGNATURE

ITEMIZATION OF AMOUNT FINANCED

Sales Tax (if any) $_____

1. Cash Sale Price ..... $_____
2. a. Cash Downpayment .... $_____
   b. Trade-in ..... $_____
   DESCRIPTION _____
   Total Downpayment (a + b) ..... $_____
3. Unpaid Balance of Cash Sale Price (1-2) $_____
4. Insurance (for term of credit)
   Credit Life .....$ _____
   Credit Disability .$ _____
   Property .....$ _____
   Total Insurance Charges ..... $_____
5. Amount Financed (3 + 4) ..... $_____
6. Finance Charge ..... $_____
7. Total of Payments (5 + 6) ..... $_____
8. Total Sale Price (1 + 4 + 6) ..... $_____
9. Payable in _____ monthly payments of $ _____ each beginning _____ and continuing same day of each month until fully paid.

PROMISE TO PAY. Instead of the Cash Price, I promise to pay the Total Sale Price and I agree to pay you (or buyer of this contract) a Total of Payments in monthly payments in the amounts and on the dates stated above. I will pay at your business address, or other address given me. If more than one Buyer is named above, you may enforce this contract against all or any Buyers, but not in a combined amount greater than amount owed.

PREPAYMENT. If I fully prepay before the final due date, the amount I owe will be reduced by (a) unearned Finance Charges computed at the Annual Percentage Rate shown above, the unpaid balances of Amount Financed scheduled for the time after prepayment to maturity, (b) unearned credit insurance charges determined by the "Rule of 78ths", and (c) unearned property insurance charges, determined by assuming an equal part is earned each month.

FAILURE TO PAY. If I don't pay on time, all my payments may become due at once, and without notifying me before bringing suit, you may sue me for the total amount I owe, less the same unearned Finance Charges I would receive if I fully prepaid. You may also repossess the goods described above.

SECURITY. You waive any security interest in my home that could result if the goods are installed.

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

NOTICE TO THE BUYER: 1. Do not sign this agreement before you read it or if it contains any blank spaces. 2. You are entitled to an exact copy of this contract.

I HAVE READ AND RECEIVED A COMPLETED, READABLE, SIGNED COPY OF THIS CONTRACT.

SELLER: _____ **BUYER:** _____

By _____ **BUYER:** _____

FORM 1835 NB (Rev. 1-83)

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Promissory Note and Security Agreement

The terms of payment include the total number of payments and their amount, the amount financed, when your first payment is due, charges for insurance, if elected, and other conditions of payment. Note that the finance charge as a dollar amount and the annual percentage rate can be easily identified by the boldface boxes. This allows you to readily see exactly how much you are paying for credit and at what rate. Make sure all of the boxes or blanks are filled in before signing the contract.

Late charges or **extension charges** are added to an installment payment which is not paid when due. The Truth in Lending Act requires a written statement identifying the amount or the method used to calculate charges for late payment or default.

Insurance (life, disability and/or property) may be offered in connection with consumer credit to protect you and your family as well as the creditor. State laws in the United States and similar regulations in Canada determine when insurance may be sold, what types may be sold and what premiums may be charged. Generally, it is not required. In deciding whether or not to take credit insurance, consider your age, health, the length of the repayment period and the amount of the loan, the amount of other insurance protection you may have, and of course its cost through the creditor.

Itemization of the amount financed in this contract is broken down to show how it was derived. Any official fees or charges for credit insurance are added to the loan proceeds (the amount you want to borrow) to determine the total amount being financed.

The prepayment privilege requires the creditor to accept payment in advance of the due date and may also provide for a refund of credit charges proportionate to the amount prepaid (as it does in this case). In some states and provinces, the law requires creditors to accept advance payment. The law also may regulate the amount of credit charges to be refunded. Where there are no legal provisions concerning prepayments or refunds in respect to prepayment, determine what policy the creditor follows.

The acceleration clause gives the creditor the right to demand immediate and full payment of the net unpaid balance when one or more installments are overdue. This is usually done only in the case of a serious delinquency.

A security agreement, if applicable, specifies the property you are pledging to guarantee the loan. If you default in your payments and the property is repossessed, this agreement allows the creditor to sell the property to recover the amount you owe. If an automobile is used as security, information on the car is given on the contract for identification purposes.

A cosigner may be required under some circumstances. This person adds his signature to yours on a credit agreement and thereby agrees to pay the debt if you do not.

In addition to these terms, credit contracts may include:

- **an add-on clause**, which permits the purchase of more than one item on an installment contract. This eliminates the necessity of drawing up an additional contract for each purchase. According to the U.S. Consumer Credit Protection Act, in the case of items purchased on different dates, the first purchased shall be considered first paid for; in the case of items purchased on the same date, the lowest priced shall be considered first paid for.
- **a balloon payment**—usually the last installment payment—which is much larger than all other payments. The Truth in Lending Act requires all contracts which include this type of payment to identify the amount of the payment as a "balloon payment." Balloon payments are prohibited by law in some states and provinces.
- **restrictions** on moving property out of the state or country, or against selling property before payment is completed.

Managing Credit Dollars

The first section on *Understanding Consumer Credit* presented basic information on credit—what it is, what it costs, kinds and sources of credit and what to watch for when applying for it. This section asks the basic questions: Should you use credit? and, How can you best make it work *for* you, not against you?

When you treat consumer credit as a privilege—which it is—it can help you have more and enjoy more. But if you misuse credit or take it for granted, it may become a trap. You have a choice. Either you can control credit—or credit will control you! It's as simple as that—and the choice is up to you. Skillful management of credit dollars involves:

- **determining how much credit you can afford**—developing a spending plan based on individual needs, values, goals and income;
- **evaluating whether to use credit**—comparing the use of credit with saving to pay cash, using cash reserves or doing without;
- **shopping for credit**—recognizing the best plan to meet your needs and requirements; and
- **knowing what to do and acting promptly when financial difficulties arise.**

Can You Afford Credit?

Sometimes you may see articles recommending that credit use be limited to fifteen or twenty percent of your current take-home pay, excluding mortgage payments. While this may serve as a rough guideline for some, it may be totally unrealistic for others. No two people spend their income in exactly the same way. We each have personal values and goals which influence decisions on where we want our money to go. Therefore, we must determine our own financial limits and plan spending and credit use accordingly.

Monthly Income (after deductions)

Wages or salary	$_____
Alimony/child support	$_____
Social Security or Canada Pension Plan	$_____
Pension	$_____
Other earnings (commissions, interest, tips, dividends, public assistance, etc.)	$_____
Total Income	$_____

Monthly Fixed Expenses

Rent or mortgage	$_____
Utilities	$_____
Installment payments	$_____
Contributions	$_____
Savings	$_____
Other _____	$_____
_____	$_____
_____	$_____

Monthly Flexible Expenses

Food	$_____
Clothing	$_____
Transportation	$_____
Medical and dental care	$_____
Recreation and entertainment	$_____
Gifts	$_____
Other _____	$_____
_____	$_____
_____	$_____

Periodic Expenses

Taxes (not deducted from income)	$_____
Insurance (car, medical, home)	$_____
School tuition	$_____
Vacation	$_____
Membership dues	$_____
Subscriptions	$_____
Other _____	$_____
_____	$_____
_____	$_____
Total Expenses	$_____

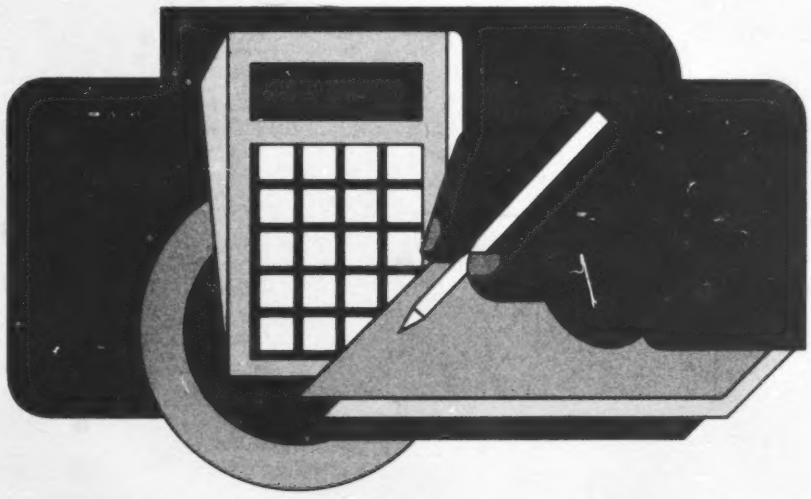
Total Income	$_____
minus Total Expenses	$_____
Balance	$_____

The first and most important single factor in controlling credit is to limit its use to amounts you can pay safely out of current and future income.

A carefully devised spending plan based on needs and wants can tell you better than any other way how much you can afford to spend. This involves analyzing your financial situation in terms of the money you earn and the expenses you must meet.*

Since credit payments usually are made by the month, it may be more helpful to consider income and expenses on a monthly basis also. The accompanying chart will help you determine how much credit you can afford to use each month. The following questions may serve as a guide.

- **How much money will you have to spend each month?** Your net income (total income minus deductions for taxes, social security, insurance, etc.) plus any other earnings will give you this figure.
- **How much must you spend to meet monthly expenses?** These include *fixed expenses*—those you have already promised to pay on specific dates and in specific amounts—and *flexible expenses*—those which vary in amount from month to month. If you do not keep a record, past spending, canceled checks and receipts can help you estimate these expenses.
- **How much should you set aside each month to meet periodic expenses as they arise?** Divide the total by 12 to arrive at the amount to set aside each month to handle these expenses.
- **How much will you have left for credit payments or other purposes?** Subtract total monthly expenses from total monthly income. The balance is the largest amount you can safely plan to use for credit payments and other purposes.



Your answers to the preceding questions will show one of three important facts concerning your personal finances.

Expenses are greater than income. In this case you have no credit capacity. In fact, it will be necessary to reduce spending, use savings, or increase income to meet current obligations.

Income meets expenses but there is no balance left. In this case, you should postpone taking on credit obligations until your financial situation improves—especially if you are already making payments on goods and services acquired through the use of credit. If there are items which become a necessity and which you can obtain only through the use of credit, it will be necessary to reduce other spending or increase income to provide money to meet payments.

A balance is left each month. In this case, plan how best to use the balance of your income. Long-range financial planning is necessary at every income level and every stage of life to meet present needs and wants, to pay off current debts, and to reach future goals. Once you have decided what you want to do with your monthly balance, you will need to decide whether you can carry out your plans best *by the use of credit, by saving or investing your money, by immediate cash purchases or by a combination of all these.*

Your plan will need to be revised periodically as you pay off some obligations, inflation pushes prices upward, taxes take a larger bite of income, and individual circumstances change.

Before assuming any financial obligations, however, it is not enough to look just at the "here and now." As credit commits future income, you must also look ahead and anticipate any changes which might occur. While no one has a crystal ball, you can usually foresee certain situations which are likely to increase expenses or alter your ability to meet them—a youngster starting school, a teen going to college, a spouse quitting work, the purchase of a house or retirement, for example. By reviewing these potential changes and acting with care, credit will work *for* you, allowing you to achieve your personal and financial goals.

*YOUR FINANCIAL PLAN, listed inside the back cover, provides additional information on setting up an overall spending and saving plan.

Should You Use Consumer Credit?

In a private enterprise economy, the consumer has more freedom of choice in deciding how to use his income than under any other economic system. With the exception of service credit, established as the most convenient method to pay for utilities and some other services, using consumer credit is a matter of personal choice.

Your decision to use credit will depend on your needs, the amount of money you have to spend, and the alternatives that are available to you. For instance, can you wait until you save enough cash? Are you willing to wait? Do you have savings which you might use? Do you have investments or securities you are willing to sell to obtain the money needed to pay cash? To decide, consider the personal economic aspects of each method.

Saving to Pay Cash vs. Buying on Credit

Saving in advance for a purchase means putting aside an amount of money each month and waiting until there is enough to pay cash. Using credit means obtaining goods and services now and saving afterwards to make installment payments.

Surprisingly, the two methods have a great deal in common. Both saving to pay cash and installment payments come out of current income and reduce the amount of money an individual has to spend. In both cases, over a period of time, the financial situation is improved—either by building up cash reserves or by reducing credit obligations. In addition, both saving to pay cash and using credit offer a way to meet a specific need or reach a certain goal.

But there are three basic differences. First, using credit costs money whereas savings—if invested—can earn money. However, you should consider that in the time required to save cash, the prices of some goods and services may increase as much or more than the interest that could be earned on savings.

Secondly, saving to pay cash means delaying purchases while buying on credit makes it possible to obtain goods and services immediately.

Lastly, how difficult is it for you to save? **If you cannot afford to save for a purchase, you cannot afford to buy it on credit,** as both methods use current income. Savings for a wanted item should be money in addition to what you have set aside for an emergency fund. If you do not have some money saved for emergencies, you need to cut down on additional spending until you do. Be realistic in the amount you can save—it doesn't do any good if you must continually dip into savings to meet normal living expenses.

One of the easiest ways to save, whether for a particular purchase or to build an emergency fund, is to have a set sum transferred from your checking account to a savings account periodically. Or, have your employer deduct it from your pay if the company has a payroll savings plan or credit union. It is much easier to save when the money never passes through your hands! When you pay off a bill or a loan, continue paying the amount to your savings account. As the money has been in your spending plan all along, this should prove relatively painless.

Using Credit vs. Spending Cash Reserves

Generally, the interest rate paid on savings and investments is considerably lower than the finance charge for credit. Therefore, if you have a savings account (in addition to some emergency "back-up" reserves) or investments you might sell, you may wish to consider using these rather than either of the two methods previously discussed.

To decide, compare the annual percentage rate for credit with the interest rate earned on savings or the market yield on securities which could be sold. Or, compare the dollar cost of credit with the dollars you will sacrifice in interest, dividends and profits if you draw money out of savings or sell investments. Also, consider whether you will be able or likely to replace savings and investments once you have converted them to cash to meet present needs.

Savings provide security. Therefore, if paying cash means depleting cash reserves, you may prefer to use credit and budget payments out of future income.

These questions should be considered in determining whether you should use consumer credit and the amount you can afford should you choose to do so.

- How long will you have to save in advance in order to pay cash?
- Can you and are you willing to wait while you save?
- Is the price of the goods to be purchased likely to be higher or lower in the future?
- Do you have the self-discipline to save regularly, to replace savings and investments used?
- Can you borrow against savings with a passbook or savings account loan?
- Will the satisfactions of having the purchase while you are paying for it be worth the extra cost for credit?
- Will both the total payment and monthly payments fit into your spending and saving plan?
- Will the purchase still have lasting value after payments are completed?

Whatever the decision, it is a personal one which you must make yourself.

Shopping for Credit

As a rule, today's consumers try to be smart shoppers. They are conscious of brand names, makes, models, quality, quantity and service—and they consider them carefully when purchasing goods and services.

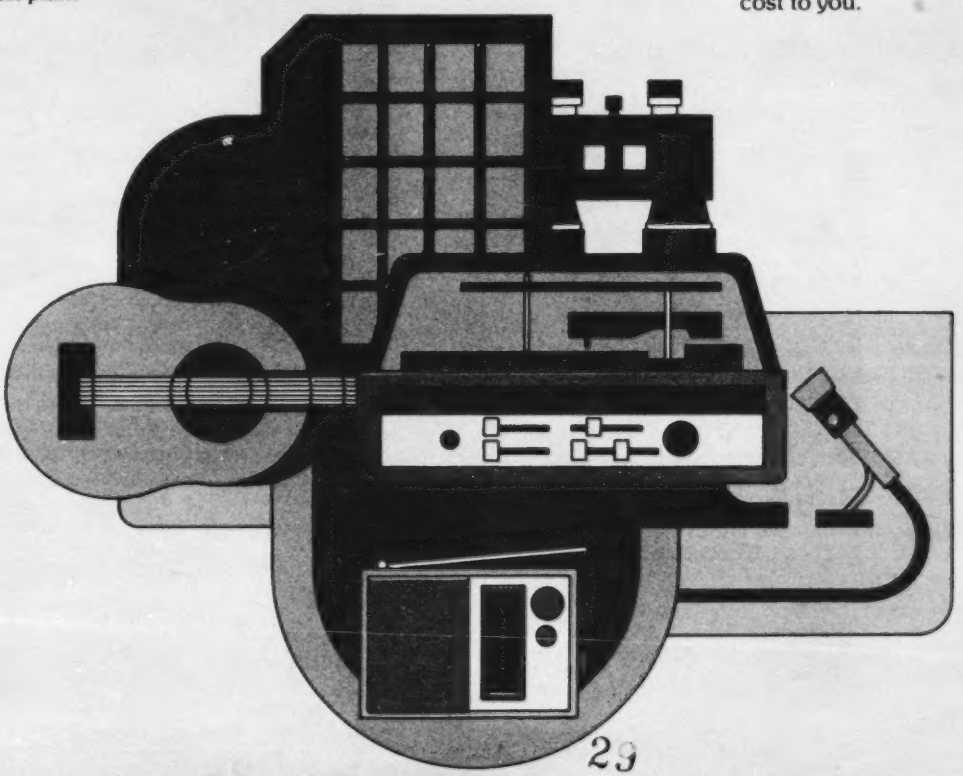
Likewise, there are differences to consider in the forms and sources of consumer credit available. If you buy on time, you can deal with one of several different retailers who offer credit terms. If you borrow money, you may be able to obtain a loan from one of several banks or consumer finance companies, a credit union if you are a member, an insurance company if you have a life insurance policy with a cash loan value, or through a credit card or check-credit plan.

Therefore, once you decide to use consumer credit, it is equally important to shop for credit and evaluate its costs and terms—choosing the services that are best for you.

Now that laws require creditors to state finance charges in terms of dollar amount and annual percentage rate, it might appear that the only thing necessary to make a decision is to determine which source offers the lowest price by comparing these two figures. While the charge for credit is of real concern to most consumers when choosing a credit plan, there are other factors that are equally important to consider. These four guidelines may be helpful in evaluating the plan and source that best meet your individual needs and requirements.

- **Maturity of the contract**—will the size and number of payments fit into your spending plan without straining?
- **Total cost**—the total of all payments, including both the price for credit and the price of goods and services purchased.
- **Security pledged**—what would you lose if you defaulted on your payments?
- **Other conditions for credit**—services or terms that may outweigh the differences in credit charges.

Since the cost of a given amount of credit increases with the length of the repayment period, the cost of credit can be reduced by repaying in the shortest time possible. However, if large payments strain your spending and saving plan, you may want to repay over a longer period of time in order to reduce the monthly payments, even though this increases the total cost to you.



Compare contracts for different lenghts of time to decide whether the lower monthly payments and reduced risk of upsetting your spending plan are worth the extra cost involved. The following illustration shows the difference in monthly payments and total dollar cost for contracts with repayment plans of 18, 24 and 36 months. The amount of credit received ($510) and the annual percentage rate (19%) are the same for all three plans.

Repayment period	18 mos.	24 mos.	36 mos.
Total amount to be repaid	$590.04	$617.04	$672.84
Amount financed	510.00	510.00	510.00
Finance charge	80.04	107.04	162.84
Monthly payment	32.78	25.71	18.69
Annual percentage rate	19%	19%	19%

In making a cost comparison of lenders who deal in cash credit, only the charges for credit will vary. But when comparing sales credit, both the price for credit and the prices for merchandise might vary. For example, suppose that you are shopping for a color television to be financed over a one-year period. You find the identical model at three different stores, but at these varying prices.

Credit source	Store A	Store B	Store C
Price of purchase	$379.00	$388.00	$410.00
Dollar finance charge	$56.00	$32.00	$28.00
Annual percentage rate	27%	13%	12.5%
Monthly payment	$36.25	$35.00	$36.50
Number of payments	12	12	12
Total amount paid	$435.00	$420.00	$438.00

Obviously, if you can afford to pay cash, Store A offers the best buy. But what about the price for credit? Assuming you financed the entire amount, the $56 is almost twice the finance charge of the other two stores. The price for credit more than makes up for the difference in the price of the TV. On the other hand, if you shop for the lowest credit price only, you might prefer to deal with Store C. But in this case, even though the finance charge is lowest, the total amount you will pay is highest.

Checking monthly payments is another means of comparing total cost. In this example the monthly payments differ only by $1.50. Many consumers tend to shrug off this amount as hardly worth the additional shopping. However, consider that $1.50 over a period of a year amounts to $18.00.

It is not necessary to obtain credit where you shop. For major purchases you also may wish to consider a cash loan, as it may be less costly or otherwise preferable, than buying on credit through any of the stores.

In nearly every credit transaction, you have some choice concerning the type, source and price of credit you use. You will recall from the discussion on types and sources of consumer credit, pages 13-19, that a large number of retailers and lending institutions compete for the opportunity to extend you credit. You will find it to your advantage to check with several different sources to evaluate the credit terms that best meet your particular needs and requirements.

The following chart will serve as a guide as you shop for credit and compare credit costs.

CREDIT SOURCE					
PRICE OF PURCHASE					
DOWN PAYMENT (if any)					
AMOUNT FINANCED					
DOLLAR FINANCE CHARGE					
ANNUAL PERCENTAGE RATE					
MONTHLY PAYMENT					
NUMBER OF PAYMENTS					
TOTAL AMOUNT PAID					

Some credit users want to obtain only a small amount of credit as promptly and as easily as possible—and are willing to pay for this convenience. Others want a large amount of credit at the lowest possible price. Still others are concerned with provisions for repayment . . . with obtaining credit with little or no tangible security . . . with arranging a convenient repayment plan . . . with the services made available by the creditor . . . or with the lender's policies concerning delinquency. If these areas (or others outlined under *Consumer Credit Agreements*, pages 20-23) are of particular concern to you, ask about them as you shop for credit. In any case, make sure you understand the lender's policies in these areas before you sign a contract.

In addition to the guidelines previously indicated, these questions may help you find the source and credit plan that are best for you.

- Does the creditor meet high standards of reliability and fairness?
- Can you meet the creditor's security requirements?
- Does the total cost of credit compare favorably with other sources of credit that are available to you?
- Does the size of the monthly payment fit into your money management plan?
- Can you choose a payment date that is convenient in terms of your overall spending plan?
- Are all terms of the credit agreement stated clearly?
- Can credit be obtained promptly?
- Can credit be obtained conveniently?
- Are credit transactions handled confidentially?
- Is money management help available if needed?
- Are charges for late payment reasonable?
- Will you receive a refund on credit charges if you prepay?
- If you choose to purchase credit insurance, does it provide adequate protection at a fair cost?

Once you learn to judge the source and terms of credit that are best for your particular needs and situation, you are in a position to enjoy more fully credit's advantages. Wise shopping can help you make the most of credit dollars to satisfy current needs and wants and to reach future goals.

Handling Financial Difficulties

Financial difficulties occur when expenses and obligations become greater than income or ability to meet payments. Money problems may be the result of inexperience in handling finances, mismanagement, marital problems or divorce, unexpected emergencies, interrupted income, or any number of situations that cause a difference in the ability of the credit user to repay. Financial problems may be handled in different ways, depending on their seriousness. Whatever the problem, it is important to know what to do about it and to act promptly.

Planning Helps

Money problems such as "running short" at the end of the month, handling unexpected expenses, or failing to plan ahead may be solved by better money management.

Whether the situation calls for developing a money management plan or revising an existing plan, the first step is to analyze spending to see what changes can be made. With needs and goals in mind, it may be possible to reduce or eliminate unnecessary expenditures and to solve minor money problems.

Danger Signals

Is an increasing percentage of your income going to pay off debts?

Are you near or at the limit on your lines of credit?

Are you extending repayment schedules—paying in 60 or 90 days bills that you once paid in 30?

Can you only make the minimum payments on your revolving charge accounts?

Are you paying bills with money earmarked for something else?

Are you borrowing to pay for items you used to buy with cash?

Are you chronically late in paying your bills?

Are you tapping your savings to pay current bills?

Is your savings cushion inadequate or nonexistent?

Do you take out a new loan before the old one is paid off, or take a new one out to pay off the old loan?

Do you put off medical or dental visits because you can't afford them right now?

Are you threatened with repossession of your car or credit cards, or with other legal action?

Are you working overtime just to make ends meet?

If you lost your job, would you be in immediate financial difficulty?

Are you unsure about how much you owe?

Do you worry a lot about money?

A "yes" to any of these questions should give pause for thought. While a single red flag is not a sign of impending doom, it is an indication that you need to proceed with caution for a while—revise and update your spending plan, cut back on credit use and be alert for other signs of overspending.

More Serious Financial Problems

One month a family's income, outlook and spending are in line. The next month something unexpected happens —a sudden illness, an accident, a job change, a strike or other lay-off, unemployment, or a change in the number of dependents. What can be done about these financial problems? There are several alternatives to consider.

There may be ways to increase income to meet demands. The head of the household may be able to work overtime, find extra part-time work or possibly a better paying job. If both spouses are not working, an additional full- or part-time job in the family—even temporarily—can be a boost, particularly if children are in school and do not need much supervision. Older children may be able to earn money through part-time jobs to relieve some of the pressure.

Try to cut living expenses to a minimum. Stop buying clothes. Omit nonessential food products (i.e., snack foods, pop, candy, etc.) from the grocery cart. Switch to less expensive cuts of meat or substitute other protein sources occasionally. Use the car less to reduce gasoline costs. Cut entertaining at home and keep it inexpensive.

If you can follow your "debt emergency program" for two or three months, you may find yourself back on the right track. But if income cannot be increased enough to pay debts and obligations, or expenses cannot be reduced sufficiently, outside help is required.

If you are in a situation where you want to pay but cannot do so at the moment, you can most likely resolve the problem within the credit system itself. Most creditors, if they know the facts surrounding your problem and are convinced of your good will and intent to pay, usually are understanding and willing to help. They may defer payments or refinance the debt to reduce the size of the monthly payments. It may be possible to return merchandise bought on time before repossession is necessary. But it is important to go to all your creditors before payments are overdue, or as soon as possible thereafter, to see what arrangements can be made for fulfilling obligations. The worst thing you can do if you are not able to meet payments on schedule is to avoid your creditors.

What if obligations are too great to be handled by temporarily deferring or reducing payments, or if some creditors are unwilling to wait for payments? It may be necessary to find a willing lending agency who will arrange a loan large enough to pay off all other bills and arrange one lower monthly payment extended over a longer period of time. This is called a *consolidation loan*. While such a loan is a legitimate way to make monthly payments more manageable, *it can only work effectively if you forego additional credit purchases and get spending in line with income*. Lowered monthly payments do not mean you have more money to spend—they just alleviate some of the pressure. In addition, consolidation loans can be more costly than paying off debts individually, depending on the total finance charges in both cases and the length of the extended repayment period. On the other hand, this type of loan may help you get back on stronger financial footing. Likewise, a consolidation loan will not damage your credit history as chronically late or skipped payments certainly will.

Some creditors offer financial counseling as a service to customers. They will look at your financial situation and suggest alternatives for you to consider. They can tell whether a consolidation loan would be of significant help or whether other arrangements would be preferable.

If you do not talk to your creditors about your financial difficulties and ignore making payments when due, you may find your account turned over to an independent debt collector. The **Fair Debt Collection Practices Act** in the U.S., effective March 20, 1978, was designed to insure that consumers were treated fairly by debt collectors. (Businesses handling their own collections are not covered by the Act.) While it does not cancel a genuine debt that you owe, the Act does give you certain rights.

Within five days after you are first contacted, the debt collector must send written notice telling you the amount of money you owe, to whom, and what to do if you feel you do not owe the money. If you send a letter within 30 days stating you do not owe the amount, a debt collector cannot make further collection efforts until you are sent verification of the debt in writing by the collector. The law does not require the collector to secure copies of credit agreements. A written

description of the agreement creating the debt or the specifics of the debt may be obtained verbally from the original credit grantor and will meet the requirements of the law. If a collector cannot verify a debt he must not attempt to collect it.

In addition, the Fair Debt Collection Practices Act makes it a federal offense for debt collectors to:

- use abusive language, threaten violence or contact you at inconvenient times or places;
- misrepresent themselves to you—for example, pretend to be an attorney, government official or policeman;
- use unfair means to collect debts;
- contact anyone else concerning the debt, except in an attempt to locate you; and
- collect more than is legally owed or apply payments to a debt in dispute.

You can stop a collector from communicating with you by notifying the collector in writing that all contacts are to cease. If the collector chooses to go to court, suits to force payment must be brought either in the judicial district where you live or in the one where the contract was signed.

The Fair Debt Collection Practices Act is enforced by the Federal Trade Commission and federal bank regulatory agencies. You may also be protected under various state laws; contact your state's Attorney General for information. Violators of the Act are liable for damages, which are summarized in the chart on pages 36-37.

Credit Counseling

Some families and individuals cannot prevent their financial problems, which may arise from a sudden illness. . . a death in the family. . . unemployment . . . or other unforeseen circumstances. Others simply do not know how to handle money or credit—impulse buyers who see something and buy without giving any thought as to whether they can afford the item. . . those "keeping up with the Joneses," who will buy anything that is bigger, better, different or costs more money than comparable items their neighbors buy. . . the "soft touches" who simply cannot resist a sales pitch.

When families and individuals become involved in serious financial difficulties which none of the solutions previously discussed will satisfy, one of the best solutions to date has been the credit counseling service established in many communities throughout the U.S. and Canada. Over 200 of these are sponsored by the National Foundation for Consumer Credit. The credit counseling services are non-profit organizations designed to aid overextended debtors in all income brackets in working out the payment of bills already incurred. These agencies have the support of local merchants, financial institutions, educators, religious leaders, service organizations and many other segments of the community.

The main purpose of credit counseling organizations is to help the financially-pressed family or individual avoid the undesirable consequences of bankruptcy if planning and discipline will solve the problem.

Credit counseling services operate at two levels. First, they try to work out with the debtor a reasonable financial plan which, if his income remains stable, will allow for a certain amount to be applied to his debts. By counseling the debtor and keeping the spending plan at a realistic level, these organizations help financially-troubled individuals and families help themselves.

Second, if the difference between income and living expenses is not enough to cover full payment of current obligations, the counseling service will try to arrange new repayment schedules with creditors. If this is possible, the debtor gives the counseling service an established amount out of each paycheck. The service, in turn, distributes this amount to creditors. There is no charge or, at most, only a nominal charge for this service regardless of income bracket.

In addition to national and community-sponsored non-profit counseling services, advice on handling finances is available from welfare organizations, legal aid societies, clergy and some financial institutions.

Before going to any credit counselor, know who sponsors the program. . . what, if any, charges will be made. . . and how the plan operates. Creditors, the Better Business Bureau, the Chamber of Commerce or the National Foundation for Consumer Credit (address on page 35) can provide information on credit counseling services and whether there is a nonprofit agency available in your area.

But a word of caution! Do not confuse credit counseling services available at little or no charge with private concerns or fee agencies in the business of debt-pooling—also known as prorating, debt-adjusting or debt-liquidation. These concerns frequently charge fees as high as 35 percent or more of the total amount of the customer's debt. Such activities are illegal in some states.

As a Last Resort

In extreme cases of financial difficulty, when all other roads to solvency are blocked, the over-indebted family or individual may find it necessary to seek relief under the **U.S. Bankruptcy Act of 1978.*** Under this act, the debtor may file a petition for straight bankruptcy or seek protection under Chapter 13.

Bankruptcy involves filing a petition in court to have a credit-user legally declared unable to meet credit obligations. Once a person is judged bankrupt by the court, all assets and possessions, except those exempted by federal or state law, are turned over to the court trustee to be sold. The proceeds are then distributed to creditors. Any remaining debt is discharged—with the exception of child support, alimony, back-taxes and in some circumstances, government-backed student loans. With the court's approval, however, creditors may obtain reaffirmation or promises of payment for legally-erased debts during the bankruptcy proceedings.

Providing there are no other liens held against the property, debtors in the U.S. are allowed to retain up to $7,500 equity in a home (an equivalent amount is allowed for renters) and up to $1,200 equity in a motor vehicle. In addition, debtors may retain up to $200 interest per item in household goods, up to $400 worth of any other property, $750 worth of implements, books or tools of trade, $500 worth of jewelry, and any professionally prescribed health aids. If both husband and wife file jointly, the dollar amount doubles. Other protected assets include social security payments, veteran's benefits,

unemployment compensation, alimony and pension funds. Should the state exemption laws be more liberal than the federal law, a debtor may opt for the more favorable allowances, barring any state laws to the contrary.

In lieu of straight bankruptcy, one may select the more favorable provisions of Chapter 13, which allows debtors with regular incomes—wage earners, self-employed persons or those receiving a pension or alimony—to pay off credit obligations from future earnings under the supervision and protection of the bankruptcy court.

Although the creditors' approval is not required, most respond favorably to such plans because they receive at least partial payment. The plan may extend for three years or, with special permission, for five years, during which time creditors must suspend all collection activities against the borrower and cosigner. If, after six years or 70% of one's debts have been repaid, the individual is still unable to meet the remaining credit obligations, a petition for straight bankruptcy may be filed.

How much does it cost to file for bankruptcy? While the actual filing fee is $60, other costs vary. Trustees generally receive a percentage of the monies collected, whereas attorneys' fees depend upon their credentials and the complexity of the case. Although it is possible to reduce these costs by obtaining the legal forms in a stationery store and filing them yourself, an attorney is highly recommended—accuracy in completing the forms is imperative, and a lawyer may be aware of provisions which could save the debtor money and/or property.

Are persons who file for bankruptcy likely to get credit again? Probably, but be aware that such reports are retained in credit bureau files for 10 years. This extreme step, therefore, should be considered only when no other available options for solving financial problems exist.

*In Canada, the Bankruptcy Act, Part X, Orderly Payment of Debts, provides similar legislation, but only in those provinces which have requested it.

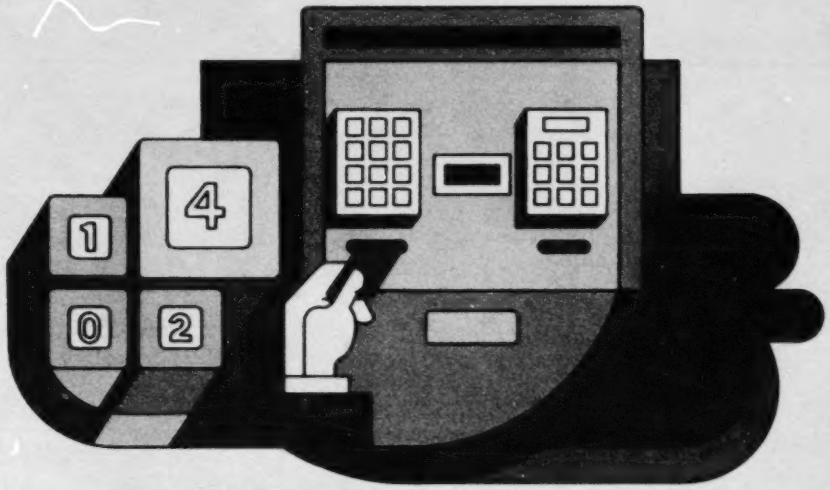
Managing Credit in the Future

As you look down the road into your financial future, what do you see? More education? Marriage? Children? Supporting elderly parents? The way you handle credit and other financial decisions could make a big difference in successfully reaching the goals you set for yourself or your family and in meeting the financial responsibilities you undertake. But even if you manage credit wisely today, there are some factors that will test that ability in the future.

It has been said that the only certainties in life are death and taxes. Most economists predict that we will soon add *inflation* to that brief list. While the degree of inflation may vary from year to year, inflation itself seems here to stay.

Inflation will affect the amount of credit you can afford and perhaps your decision to use credit at all. Since credit commits future income, your decision requires a realistic estimate of future expenses. The chart on page 24 will need to be evaluated and revised periodically to reflect these increases. If income has kept pace with inflation or certain expenses have decreased for some reason (the kids are finally out of school!), then the amount of credit obligations you can afford to assume will probably remain the same or may even increase. If income does not quite keep up with increased costs, however, something will have to give.

In addition, inflation may influence your decision to save, use credit or use existing savings to pay for a large purchase. When you use credit in a time of inflation, you are essentially paying off the debt in "cheaper" dollars—dollars that don't buy as much as they used to. This idea is particularly attractive when purchasing a costly item, such as an automobile, major home appliances, or



home improvements. The decision would also depend on how your savings or other investments were keeping pace with inflation.

Technology is also having an impact on the credit world. Electronic Funds Transfer Systems, EFTS for short, are the current trend. EFTS is a complex communications network through which funds are speedily moved about between the accounts of consumers, retailers and financial institutions. In EFTS, checks, currency and mail are replaced by communications and data processing. You may already be familiar with some portions of the EFT system and not realize it. For example, many supermarkets "talk" to local banks electronically to verify customers' checks and obtain credit authorization.

Legislators are still working out the "ground rules" for establishing a nationwide EFT system. Many factors must be considered, not the least of which is consumer protection in the areas of privacy, liability for unauthorized use of a debit card, proof of purchase, return privileges and records of transactions.

How does the advent of EFTS affect you as a credit user? You may find certain features of EFTS quite advantageous—the speed and ease with which you can pay your bills, the convenience of having a number of financial services combined in a single account, and the opportunity to transact many of these in places where you shop or work. However, because funds are transferred almost immediately, it will require that you keep accurate records of your transactions so that you do not overdraw your account. It will be even more important that you maintain a good credit history, as it can be verified on the spot.

In Conclusion

Consumer credit, in its many forms, is one of the most powerful economic forces in our society. Used with care and understanding, it can help you have more and enjoy more. But used carelessly, it can make life miserable.

Credit laws have been legislated to inform and protect you. Unfortunately, there is no way to "legislate" good judgment in using credit. You must develop this ability yourself. The primary objective of this booklet has been to provide you with the information needed to recognize credit's advantages, disadvantages and responsibilities.

Suggested Resources

Organizations

Many trade associations, businesses and government agencies provide information on credit to consumers and educators upon written request. Some of these are listed below. Additional government agencies are given in the chart on page 37.

United States

American Bankers Association
Public Relations Office
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

American Council of Life Insurance
Educational and Community Services
1850 K Street, N.W.
Washington, D.C. 20006

Associated Credit Bureaus, Inc.
16211 Park Ten Place
Houston, Texas 77218

Credit Union National Association, Inc.
P.O. Box 431
Madison, Wisconsin 53701

Household International
Money Management Institute
2700 Sanders Road
Prospect Heights, Illinois 60070

National Consumer Finance Association
1101 14th Street, N.W.
Washington, D.C. 20005

National Foundation for Consumer Credit
8701 Georgia Avenue, Suite 601
Silver Spring, Maryland 20910

United States League of Savings Associations
Public Relations and Public Affairs Department
111 East Wacker Drive
Chicago, Illinois 60601

U.S. Office of Consumer Affairs
1009 Premier Building
Washington, D.C. 20201

Canada

Association of Canadian Financial Corporations
115 The Danforth Avenue, Suite 302
Toronto, Ontario M4K 1N2

Canadian Bankers' Association
P.O. Box 282
Toronto Dominion Centre
Toronto, Ontario M5K 1K2

Canadian Co-operative Credit Society Limited
Box 800, Station U
Toronto, Ontario M8Z 5R2

Canadian Life and Health Insurance Association
Educational Division
20 Queen Street, West, Suite 2500
Toronto, Ontario M5H 3S2

Consumer and Corporate Affairs Canada
Consumer Services Branch
Place du Portage
50 Victoria Street, 17th Floor
Hull, Quebec K1A 0C9

Household Finance Corporation of Canada
Money Management Institute
85 Bloor Street East
Toronto, Ontario M4W 1B4

The Royal Bank of Canada
Consumer Affairs
P.O. Box 6001
Montreal, Quebec H3C 3A9

Books and Pamphlets

The following free or inexpensive materials provide information for those wishing to delve deeper into specific areas of credit. Addresses for selected publications are given under *Organizations*.

Give Yourself Credit (Guide to Consumer Credit Laws). Stock #052-071-005-24-2. Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

How to Choose and Use Retail Credit. Consumer Information Services, Department 703/Public Relations, Sears, Roebuck and Co., Chicago, Illinois 60684.

Matejic, Denise M. **Your Credit Rights and Responsibilities** (Leaflet 489). Cooperative Extension Service, Cook College—Rutgers University, New Brunswick, New Jersey 08903.

Some General Information About Bankruptcy; and Some General Information About Chapter 13 of the Bankruptcy Code, Adjustment of Debts of an Individual With Regular Income. Administrative Office of the United States Courts, Bankruptcy Division, Washington, D.C. 20544.

What Is A Credit Bureau?; Consumers, Credit Bureaus, And The Fair Credit Reporting Act; What Is A Debt Collector?; and **How to Manage Your Money Cleverly.** Associated Credit Bureaus, Inc.

What Truth in Lending Means to You; Fair Debt Collection Practices Act; The Fair Credit Billing Act; Equal Credit Opportunity Act. Federal Trade Commission, 6th Street and Pennsylvania Avenue, N.W., Washington, D.C. 20580.

Your Money and Credit Today and Tomorrow. The Canadian Bankers' Association.

Appendices

I. U.S. Credit Legislation in Brief

ACT (date effective)	MAJOR PROVISIONS	PAGE REFERENCE
TRUTH IN LENDING (July 1, 1969)	• Provides specific cost disclosure requirements for the annual percentage rate and the finance charge as a dollar amount	12-13
	• Requires disclosure of other loan terms and conditions	20-21
	• Regulates the advertising of credit terms	
	• Provides the right to cancel a contract when certain real estate is used as security	17
(January 25, 1971)	• Prohibits credit card issuers from sending unrequested cards	15
	• Limits a cardholder's liability for unauthorized use of a card to $50	
(October 1, 1982)	• Requires disclosures for closed-end credit (installment credit) be written in plain English and appear apart from all other information	12
	• Allows credit customer to request an itemization of the amount financed, if the creditor does not automatically provide it	22
FAIR CREDIT REPORTING ACT (April 24, 1971)	• Requires disclosure to consumers of the name and address of any consumer reporting agency which supplied reports used to deny credit, insurance or employment	10
	• Gives a consumer the right to know what is in his file, have incorrect information reinvestigated and removed, and include his version of a disputed item in the file	
	• Requires credit reporting agencies to send the consumer's version of a disputed item to certain businesses or creditors	
	• Sets forth identification requirements for consumers wishing to inspect their files	
	• Requires that consumers be notified when an investigative report is being made	
	• Limits the time certain information can be kept in a credit file	
FAIR CREDIT BILLING ACT (October 28, 1975)	• Establishes procedures for consumers and creditors to follow when billing errors occur on periodic statements for revolving credit accounts	14-15
	• Requires creditors to send a statement setting forth these procedures to consumers periodically	
	• Allows consumers to withhold payment for faulty or defective goods or services (within certain limitations) when purchased with a credit card	
	• Requires creditor to promptly credit customers' accounts and to return overpayments if requested	
EQUAL CREDIT OPPORTUNITY ACT (October 28, 1975)	• Prohibits credit discrimination based on sex and marital status	11-12
	• Prohibits creditors from requiring women to reapply for credit upon a change in marital status	
	• Requires creditors to inform applicants of acceptance or rejection of their credit application within 30 days of receiving a completed application	
	• Requires creditors to provide a written statement of the reasons for adverse action	
(March 23, 1977)	• Prohibits credit discrimination based on race, national origin, religion, age or the receipt of public assistance	8-9
(June 1, 1977)	• Requires creditors to report information on an account to credit bureaus in the names of both husband and wife if both use the account and both are liable for it	10
FAIR DEBT COLLECTION PRACTICES ACT (March 20, 1978)	• Prohibits abusive, deceptive and unfair practices by debt collectors	31-32
	• Establishes procedures for debt collectors contacting a credit user	
	• Restricts debt collector contacts with a third party	
	• Specifies that payment for several debts be applied as the consumer wishes and that no monies be applied to a debt in dispute	

PENALTIES FOR NONCOMPLIANCE	GOVERNING AGENCIES
Individual suits: • Actual damages • Twice the amount of any finance charge involved (at least $100, at most $1,000) • Court costs and reasonable attorney's fees Class action suits: • Up to $500,000 or 1% of the creditor's net worth, whichever is less Criminal penalties: • Fine of not more than $5,000 and/or • Imprisonment for not more than one year	The following federal agencies are responsible for enforcing all of these Acts. The agency to contact for information or in case of a complaint depends on the particular creditor involved. • If a retail store, department store, consumer finance company, gasoline credit card, travel and entertainment card or a state-chartered credit union is involved, contact: One of the FTC regional offices, or Federal Trade Commission (name of the Act) Washington, D.C. 20580 • If a bank is involved, contact one of the following: • If it is a nationally chartered bank, contact: Comptroller of the Currency Consumer Affairs Division Washington, D.C. 20219 • If it is a state-chartered bank and a member of the Federal Reserve System, contact: Board of Governors of the Federal Reserve System Division of Consumer Affairs Washington, D.C. 20551 • If it is a state-chartered bank and is insured by the Federal Deposit Insurance Corporation, but is *not* a member of the Federal Reserve System, contact: Federal Deposit Insurance Corporation Office of Bank Consumer Affairs Washington, D.C. 20429 • If a federally chartered or federally insured (FSLIC) savings and loan association is involved, contact: Federal Home Loan Bank Board Washington, D.C. 20552 • If a federally chartered credit union is involved, contact: National Credit Union Administration Division of Consumer Affairs Washington, D.C. 20456 On a state level, contact: • The Attorney General's Office • State Banking Department
Credit reporting agencies are liable for: • Any actual financial injury a consumer suffers as a result of the agency's failure to follow proper procedures • Any additional penalty the court may impose • Court costs and reasonable fees for the consumer's attorney Criminal penalty for those obtaining information under false pretenses and those supplying information to unauthorized persons: • Fine of not more than $5,000 and/or • Imprisonment for not more than one year	
For failure to follow proper procedures, the creditor forfeits the amount of money in dispute and any finance charges computed on that amount, up to a maximum of $50. In this case, a consumer can collect whether or not there has been a billing error.	
Individual suits: • Actual damages • An additional sum up to a maximum of $10,000 • Court costs and reasonable attorney's fees Class action suits: • Up to $500,000 or 1% of the creditor's net worth, whichever is less Time limits: • A suit may be filed no later than two years from the date the violation occurred. • If an agency begins enforcement proceedings within the two year period, cases may be filed up to one year after the proceedings begin. • If the Attorney General begins a civil suit within these two years, there is a one year extension on bringing suit.	
Individual suits: • Actual damages • An additional sum up to a maximum of $1000 • Court costs and reasonable attorney's fees Class action suits: • Up to $500,000 or 1% of the debt collector's net worth, whichever is less Time limits: • A suit may be filed no later than one year from the date the violation occurred. Frivolous lawsuits: • Third-party debt collectors may receive court-ordered compensation from a consumer to cover the cost of defending themselves in court against a suit brought in bad faith or for the purpose of harassment.	

II. The Language of Credit

Acceleration Clause. A provision allowing the creditor to ask that all future installments be paid at once if one or more installments have not been paid when due.

Add-On Clause. A provision for adding new purchases to an existing installment contract.

Add-On Charge. The finance charge calculated on the amount financed for the term of the contract and added to the amount financed to determine the total of payments.

Annual Percentage Rate. The ratio of the finance charge to the average amount of credit in use during the life of the contract, expressed as a percentage rate per year.

Bank Credit Card. A credit card issued by a bank offering a line of credit and enabling the borrower to make purchases or obtain a cash loan.

Bankruptcy. A Federal or provincial court proceeding, under which persons unable to pay their debts in full may be discharged from their legal obligations to do so, with certain exceptions.

Chapter 13 (Adjustment of Debts of an Individual with Regular Income). A plan for the repayment of debts which allows a credit user in serious financial difficulty to pay off credit obligations without declaring bankruptcy. In Canada, similar provisions are provided by Part X, Orderly Payment of Debt.

Chattel Mortgage. An instrument which transfers title to personal property to another as security for the payment of a debt. If the indebtedness is not paid according to the terms of the agreement, the holder of the mortgage has the right to obtain possession of the mortgaged property.

Collateral Note. An instrument by the terms of which the credit user delivers possession of real or personal property to the creditor as security for payment of the debt. If the credit user fails to make the payments according to the terms of the note, the creditor has a right to sell the collateral and apply the proceeds to the payment of the debt.

Composition. A settlement under Chapter 13 by which a potential bankrupt pays off his obligations by paying only a part of the total amount owed to each creditor.

Conditional Sales. Sales made under a payment contract where security interest remains with the seller until all payments are made.

Consolidation Loan. Combining several debts into one loan for the purpose of reducing payments into a single lower payment plan over a longer period of time.

Cosigner. One who agrees to pay a debt if the credit user does not.

Credit Bureau. A firm which collects, stores and distributes consumer credit history information to credit grantors under the requirements of the Fair Credit Reporting Act.

Credit History. A record of an individual's past performance with credit.

Creditor. A person or firm that extends credit services and to whom credit users are indebted.

Credit Rating. An appraisal made by an individual credit grantor of an individual's credit worthiness—the ability and willingness to pay credit obligations. These appraisals are based upon the credit grantor's own, privately developed criteria for granting credit.

Credit Risk. The chance of a loss through noncollection of a credit obligation.

Credit Worthiness. The ability and willingness to repay a debt; having a good credit history.

Default Charge. Also called *penalty charge*. An additional charge generally calculated upon an installment payment which is not paid when due.

Defer. To put off until a future time; postpone or delay. Charges made to defer payments on credit contracts are called deferral, deferment or extension charges.

Disclosure. Statement by the creditor to the debtor of all terms relevant to a contract.

Discount Charge. The finance charge calculated on the total of payments for the term of the contract and deducted in advance to determine the amount financed.

Down Payment. The initial payment on a credit purchase made before the amount to be financed and charges for credit are figured.

Durable Goods. Products which provide long-lasting and continuing services.

Extension. An agreement with the creditor which allows a borrower who is having financial difficulties to pay off the debt in smaller payments over a longer period of time.

Face-of-note. Also called *total of payments*. The total amount which the credit user promises to repay, including the finance charge and all additional charges in connection with a credit transaction.

Finance Charge. Also called *cost of credit*. The dollar amount of charges for credit, excluding taxes, filing and recording fees, license fees, registration, title and certain other legal fees when authorized; (formerly called interest, carrying charge, service charge or time price differential).

Instrument. A legal document, contract, note or any other type of written agreement.

Interest. The cost of borrowing money; included in the finance charge.

Investment. Anything in which money is or may be invested to earn a return thereon.

Line of Credit. The amount of credit a lender will extend to a borrower over a period of time.

Maturity Date. The date on which final payment is due.

Note. A written promise to pay a certain sum of money at a certain time.

Obligation. A debt, promise or moral responsibility; a duty imposed legally or socially.

Open-End Credit. A credit agreement which provides a line of credit up to a set limit, with the choice of paying in full at the end of each billing period, or paying over several billing periods with a finance charge applied on the unpaid balance.

Outstanding. Still owing.

Principal. The amount of a loan or the unpaid price of a purchase before finance charges of any kind are either added or deducted; also known as *amount financed.*

Proceeds. Also called the *amount financed.* In borrowing, the actual amount of money given or credited to the credit user; on a time purchase transaction, the balance financed.

Promissory Note. See **Note.**

Refinance. The rescheduling of payments on an installment contract; generally smaller payments extending over a longer period of time.

Refund. Unearned portion of a finance charge which is returned or credited to the credit user because of prepayment of the contract.

Repossession. Forced or voluntary surrender of merchandise as a result of inability to pay as promised.

Reserve. A sum of money or assets set aside.

Retail Installment Contract and Security Agreement. Also called a *conditional sales contract.* A written agreement between creditor and credit user which permits the credit user to receive goods and services at the time of the purchase but allows the creditor to retain title to the merchandise until payment is completed.

Revolving Credit. See **Open-End Credit.**

Right of Rescission. The right of a consumer to cancel, within three business days, a credit contract in which his or her principal place or residence is used as security. This right does not apply to first mortgage loans.

Sales Finance Agency. A financial institution which purchases contracts from retailers, after which the credit user whose contract is purchased usually makes payments to the sales finance company.

Scheduled Payment. Payment due at a particular time (or times); each of the installments in a credit agreement specified as to amount and date due.

Secured Note. A note which provides that, upon default, certain pledged or mortgaged property may be applied in payment of the debt.

Security Interest. The right granted under stated law that allows the creditor to obtain possession of the property covered in the event you do not pay on time or fulfill other contract obligations. Generally the creditor can sell the property, apply the amount received (less expenses) to the balance owed and sue the customer for any remaining amount due. State laws vary regarding creditors' rights and obligations in this area.

Share Drafts. Similar to checking accounts and offered by some credit unions, they allow members to withdraw funds, pay bills, etc., from their credit union share accounts.

Simple Interest. The finance charge computed on the principal balances outstanding as long as any portion remains unpaid.

Term. The period of time between the date a credit agreement is signed and the date final payment is due.

Terms. The conditions written into a note or contract, such as the amount of the loan or purchase, balance financed, charges, size, number and dates of payments, which set forth the rights and responsibilities of either the credit user or the creditor.

Title. Proof of ownership.

Unsecured note. A credit agreement in which the lender's only security is the credit user's signature and personal financial situation as demonstrated through the credit application.

Wage Assignment. A signed agreement which permits a creditor to collect a certain portion of a credit user's wages from his employer if payment of the contract is not made according to terms. (Prohibited by law in some states and provinces.)

Wage Garnishment. A court order requiring that a certain amount of the credit user's wages be paid by the employer directly to the creditor; legal action taken only after a credit user has defaulted. The Consumer Credit Protection Act limits the amount of disposable income subject to garnishment and prohibits the dismissal of an employee for garnishment of any one indebtedness. In Canada, most provinces have a similar law.

III. Methods for Computing Credit Charges

While a calculator may aid a student in the classroom or a consumer in the supermarket, it does not eliminate the need to know how to add, subtract, multiply and divide. So it is with credit. Even though Truth in Lending requires creditors to state the finance charge as a dollar amount, a wise credit consumer will be aware of how that amount is figured—or at least know where to go for that information. Three general methods are used most frequently by financial institutions and retail merchants in computing finance charges—the add-on, discount and declining balance methods.

Add-On Charge

The add-on method is important in both retail installment financing and cash lending. It is used by banks, sales finance agencies, retail merchants and consumer finance companies in some states.

When the add-on method is used, the finance charge is calculated on the amount financed, then added to it. This sum is the total amount to be repaid.

For example, suppose you wish to borrow $1000 and are given a quoted rate of 12% *add-on* annually. The finance charge for this loan would be $120 for one year ($1000 × .12 × 1), or $240 for two years ($1000 × .12 × 2).

According to this method, you would receive the $1000 you financed and repay that amount plus the finance charge. If you took out the loan for one year, you would repay $1120; for two years, $1240. Your monthly payment could be figured by dividing the total amount to be repaid by the number of payments you wish to make.

Discount Charge

The discount method of computing the finance charge is important primarily in the field of cash lending. It is used primarily by banks in the United States and by consumer finance companies in some states.

When the discount method is used, the finance charge is calculated on the total amount to be paid back. The borrower receives the difference between this amount and the finance charge when credit is extended.

For example, say you plan to borrow $1000 for a year and are quoted a 12% *discount* rate. Using this method, you would receive only $880—the finance charge of $120 ($1000 × .12 × 1) was subtracted from the total of payments. But if you wish to have *use* of the entire $1000, the formula above may be used to determine the total amount that must be repaid.

Since the finance charge is computed on the total amount you must repay, the charge for a one-year contract is $136.36 ($1136.36 × .12 × 1) and $315.79 ($1315.79 × .12 × 2) for a two-year period. Deduct these charges from the total of payments, and the amount of money you would receive is the same as the preceding example for add-on charges—$1000. Note, however, that the total amount to be repaid and the finance charge are greater. This difference is even more apparent on contracts with longer repayment periods.

Charge on the Declining Balances

The method of computing the finance charge on the declining balances is important in both cash lending and sales credit. The finance charge is computed by applying a percentage rate to the balance outstanding during each payment period. Such charges may be stated as either *simple interest* or *precomputed simple interest*.

With revolving lending or open-end credit, a simple interest charge is computed and collected each time a payment is made. Department stores, commercial banks, credit card agencies, other sources offering revolving credit plans, and some credit unions use this method.

F = face of note (total of payments)
P = proceeds (amount financed)
D = discount rate
T = time period

$$F = \frac{P}{1 - DT}$$

For One Year	For Two Years
$F = \frac{\$1000}{1 - (.12 \times 1)}$	$F = \frac{\$1000}{1 - (.12 \times 2)}$
$= \frac{\$1000}{.88}$	$= \frac{\$1000}{.76}$
$= \$1136.36$	$= \$1315.79$

A finance charge is calculated monthly as a percentage of the balance outstanding. For example, if the balance outstanding is $100 and the periodic (monthly) rate is 1½%, the finance charge is $1.50. Your payment is first applied to the finance charge, while the remainder goes to reduce any outstanding balance. As the balance decreases, the finance charge also decreases.

It is important to know, however, what the creditor considers as "the outstanding balance" when computing finance charges.

- **The adjusted balance** is determined by computing the finance charge on the unpaid balance at the end of the current billing period.
- **The previous balance** is obtained by calculating finance charges on the balance on the closing date of the previous month. This doesn't take into consideration any payments, credits or charges made after that date.
- **The average daily balance** is determined by dividing the sum of the balances outstanding for each day in the billing period by the number of days in the billing period. The finance charge is applied to that amount.

Consumer finance companies also compute charges as a percent per month on the declining balances. However, the relative costs of granting a small loan are greater than for a larger one. For this reason, they often vary rates according to the size of the loan —the larger the loan balance, the lower the rate. For example, 3% on $150; 2% on $150 to $300; 1% on $300 to $1000.

Creditors and credit users find it easier to deal with equal monthly payments in repaying installment loans. Therefore, the trend in recent years has been toward *precomputed* charges. The finance charge is determined in advance on scheduled declining balances, assuming that all payments will be made on time.

The following chart illustrates how a $1000 installment loan, with the finance charge precomputed at 1½% per month on the declining balances, would be repaid in equal monthly payments of principal and interest combined.

Month	Outstanding Balance	Total Monthly Payment	Application of Payment	
			To Interest	To Principal
1	$1000.00	$91.67	$15.00	$76.67
2	923.33	91.67	13.85	77.82
3	845.51	91.67	12.68	78.99
4	766.52	91.67	11.50	80.17
5	686.35	91.67	10.30	81.37
6	604.98	91.67	9.07	82.60
7	522.38	91.67	7.84	83.83
8	438.55	91.67	6.58	85.09
9	353.46	91.67	5.30	86.37
10	267.09	91.67	4.01	87.66
11	179.43	91.67	2.69	88.98
12	90.45	91.67	1.22*	90.45
		$1100.04	$100.04	$1000.00

*Interest on the principal balance outstanding during the 12th month would actually be $1.36 ($90.45 × .015). It is a common practice with precomputed loans to waive the 14 cents to permit the convenience of 12 equal monthly payments. The 14 cents discrepancy is due to rounding.

The Annual Percentage Rate

Since finance charges are computed by various methods, comparison of quoted rates can be very misleading. A given quoted rate will result in different true rates, depending on the method used to compute finance charges.

To accurately compare rates of charge, it is necessary to convert all rates to a true rate—the annual percentage rate (APR) as required by the Truth in Lending Act. The *annual percentage rate* is the ratio of the finance charge to the average amount of credit in use during the life of the contract, and is expressed as a percentage rate per year.

The APR for charges stated as a monthly percentage of the declining balance can be determined by simply multiplying the monthly rate by 12. For instance, if you are paying 1½% per month, the annual percentage rate is 18%.

Add-on and discount rates are applied to the original amount of credit extended, making the APR for these contracts somewhat more difficult to calculate. Since you begin to repay installment credit almost immediately, you only have use of about one-half of the original proceeds during the repayment period. This means that in the case of both add-on and discount rates, the equivalent annual percentage rate is roughly double the stated rate. While the quoted rate for a discount loan and an add-on loan may be the same, the true rate for a discount loan is always higher than the true rate for a comparable add-on loan.

A quoted rate of 12% per year on a $1000 installment contract will result in the following differences in dollar cost and annual percentage rate.

Stated Rate	Computed on	Dollar Cost		Annual % Rate	
		12 Mo.	24 Mo.	12 Mo.	24 Mo.
Simple	Declining balances of amount financed	$ 66.08	$129.68	12.00	12.00
Add-on	Original amount financed	120.00	240.00	21.46	21.57
Discount	Original total of payment	136.36	315.79	24.28	27.87

Estimating the Annual Percentage Rate

While retailers and lenders must state the annual percentage rate before credit is extended, it is often desirable to be able to approximate the true rate before negotiating for credit.

The actuarial method is considered the most accurate method of computing the annual percentage rate and is required under the Truth in Lending Act. It can be defined as interest computed on unpaid balances of principal at a fixed rate, with each payment applied first to interest and the remainder to principal. As computation by the actuarial method involves complicated formulas, annuity tables are commonly used to determine actuarial yields.

The constant ratio method can be used to estimate the annual percentage rate on an installment contract by the use of a simple formula, but it overstates the rate substantially. The higher the rate, the greater the inaccuracy obtained by this method.

The direct ratio method can be used to estimate the annual percentage rate by a somewhat more complex formula than the constant ratio method but is still easier than the actuarial method. The direct ratio method slightly understates the annual percentage rate as compared with the actuarial method.

The N-ratio, a new approximation method, is much more accurate than either the direct ratio or the constant ratio formulas for most loans. The N-ratio formula is somewhat more complicated than the others, however. The results of the N-ratio may be either slightly higher or slightly lower than the true ratio, depending on the maturity of the loan and the rate itself.

The following examples illustrate the use of the formulas if you borrow $1000 to be repaid in 12 equal monthly installments of $93.00 each for a finance charge of $116.00.

Approximation formulas provide reasonably accurate methods of determining the annual percentage rate of charge only when a debt is repaid according to schedule. These formulas should not be used if there is any variation in the amounts of payments or in the time periods between payments—for example, balloon payments or extended first payment loans.

R = annual percentage rate
M = number of payment periods in one year
N = number of scheduled payments
C = dollar cost of credit
P = original proceeds

Constant Ratio Method

$$R = \frac{2MC}{P(N+1)}$$

$$= \frac{2 \times 12 \times 116}{1000(12+1)}$$

$$= \frac{2784}{13{,}000}$$

$$= 21.42\%$$

Direct Ratio Method

$$R = \frac{6MC}{3P(N+1) + C(N-1)}$$

$$= \frac{6 \times 12 \times 116}{3 \times 1000(12+1) + 116(12-1)}$$

$$= \frac{8352}{40276}$$

$$= 20.74\%$$

N-Ratio Method

$$R = \frac{M(95N+9)C}{12N(N+1)(4P+C)}$$

$$= \frac{12 \times (95 \times 12 + 9) \times 116}{12 \times 12 \times 13 \times 4116}$$

$$= \frac{1599408}{7705152}$$

$$= 20.76\%$$

The annual percentage rate computed by the actuarial method for the above example is 20.76%.

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